Finance Industry Delegation

submission to the

Review of the small amount credit contract laws

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SUBMISSION TO THE REVIEW OF THE SMALL AMOUNT CREDIT CONTRACT LAWS

About the Finance Industry Delegation

The Finance Industry Delegation (the Delegation) is a consortium representing and/or reporting to the owners and management of 189 bricks and mortar and internet lending sites and 6 significant suppliers of services, including loan management software, marketing advice and compliance advice to the small amount/short term lending industry sector. 81 Australian Credit Licensees are involved in supporting the Delegation. The proportions of supporters, by lender sizes, approximately matches the industry sector as a whole.

Approximately 80% of supporters are self-funded small and medium enterprises, including franchisees from 4 franchise groups. The balance includes 4 of the 8 largest companies - none of which are public companies. Supporters are located in every State and the ACT and customers are located all over Australia, New Zealand and Papua New Guinea.

The coordinators and a core group of Delegation supporters have been involved in liaising with both State and Federal Government, on behalf of the small amount/short term industry sector, for over 14 years. This is the 39^{th} major submission the Delegation Coordinators and the core group of the supporters have been involved in preparing for State and Commonwealth Government consultation processes.

Since 2010, this liaison has included contact with three Federal Ministers and involvement in numerous Treasury Consumer and Industry Consultation Group meetings (Treasury Consultation Group), as part of the development of the National Consumer Credit Protection Act (NCCP Act) and Regulations. During this period the Delegation successfully advocated 27 changes to draft legislation and regulation.

Finance Industry Delegation Terms of Reference Recommendations

The Finance Industry Delegation's recommendations address the Terms of Reference and provide an abbreviated Executive Summary of this submission.

As listed below, these recommendations follow the order of the Terms of Reference.

1.1 The Requirement to obtain and consider a consumer's bank account statements.

Recommendations

(a) That this provision be maintained.

(b) That bank statements be permitted for marketing purposes, only if appropriate approval from the consumer, under the Privacy Act, is obtained.

1.2 The rebuttable presumption that a loan is unsuitable where the consumer is in default under another SACC or has held two other SACCs in the past 90 days.

Recommendation

That this provision be maintained.

*Restriction on repeat borrowin*g.

Recommendations:

(a) That no mandated and artificial restriction be introduced in regard to repeat borrowing, thereby maintaining appropriate recognition of the fundamental test of "not unsuitable".

(b) That no mandated and artificial restriction be introduced in regard to repeat borrowing that could be in conflict with a consumer's requirements and objectives.

Is a rebuttable presumption or a bright line test or a limitation on the number of SACCs more effective?

Recommendation

That there will not be any adoption of a bright line test/outright ban or other restriction limiting a certain number of loans, to a certain period.

1.3 The prohibitions on entering into, or increasing the credit limit of, a loan contract that has a term of 15 days or less with a consumer, and on suggesting or assisting a consumer to do so.

Recommendation

That this provision be maintained noting that, in total, the legislation effectively makes this an 18 day prohibition.

1.4 The requirement to display a warning statement about the alternatives available to SACCs.

Recommendation

That this provision be continued, with significant review of the content to reflect the actual availability of alternate funding for consumers.

1.5 The cap on fees and charges (including the maximum of a 20 per cent establishment and of a monthly four percent fee).

Recommendations

(a) That the current 20% permitted establishment fee be increased to 25%, to reflect substantially increased business costs since the original decision in 2011.

(b) That the current permitted monthly fee of 4% be maintained.

(c) That a mechanism be introduced to adjust the permitted percentage of the establishment and monthly fees, in accordance with lenders' costs.

1.6 The requirement that consumers who default under a SACC must not be charged an amount that exceeds twice the amount of the relevant loan.

Recommendation

That this provision be maintained.

1.7 The power to introduce specific protections for particular groups of consumers in sections 133C and 133CC of the NCCP Act and the protections for consumers who receive 50 per cent or more of their income under the Social Security Act 1991 in regulation 28S of the NCCP Regulations.

Recommendations

(a) That, in the interests of equity, the current provisions be extended to cover all Government Department pensions.

(b) That this provision not be extend to non-pensioners.

2.1 Whether a national database of SACCs should be established and, if so, by whom and how should it be funded.

Recommendations

(a) That a national database not be established, due to cost, complexity and process burdens.

(b) That a considerably less burdensome alternative, involving the current bank statement system, be adopted.

(c) That comprehensive credit reporting not be made mandatory.

(d) In the event that a national database is established, that the associated costs be a permitted charge, payable by the consumer.

(e) In the event that a national database concept is adopted, that multiple databases not be introduced.

(f) In the event that a national database concept is adopted, that the management of such a database be undertaken by an entity similar to the Commonwealth's Personal Property Security regime.

(g) In the event that a national database concept is adopted, consistent with the Privacy Act, the following information should be included:

i. name and identification details of the consumer;

ii. the consumer's residential address;

iii. name of lender;

iv. commencement date of loan;

v. contracted completion date of loan;

vi. regular repayment amount;

vii. repayment regularity expected (weekly, fortnightly, etc.);

viii. maximum amount of credit;

ix. balance owing, if any, on enquiry day;

x. whether in default of a SACC on enquiry day;

xi. loan details where a loan is not repaid via a bank account;

xii. date loan actually paid off;

xiii. if terminated, rather than paid off, balance outstanding at date of termination.

(h) In the event that a national database concept is adopted, that the fee for service be reimbursed by the consumer to the lender, as a disbursement from the loan funds.

(i) In the event that a national database concept is adopted, access be limited to the administrator and Australian Credit Licensees.

2.2 Whether any additional provisions relating to SACCs should be included in the Credit Act (NCCP Act), the accompanying regulations, or the National Credit Code.

Recommendations

(a) That an opportunity for a 24 hour cooling off period be introduced.

(b) To include in the Regulations a regular periodic review process to assess the interface between cost and price caps.

(c) That the provisions in ASIC Class Order 13/818 be included in the NCCP Regulations.

(d) The Delegation further recommends that a substantial editing of the current legislation, particularly the National Credit Code, be undertaken to replace terminology not in common use, to consolidate provisions where relevant, to provide appropriate definitions and to eliminate contradictions.

(e) That the clarification concerning the upper limit of a SACC amount included in ASIC Class Order 13/818 be made permanent, with inclusion in the Regulations.

(f) That the provision allowing direct debit fees for SACC repayments in certain circumstances, included in ASIC Class Order 13/818 be made permanent, with inclusion in the Regulations.

(g) That Section 117(1A)(b) of the NCCP Act be amended to require bank statements providing evidence of expenditure to be included in the assessment process.

(h) That Part 6-2 of the NCCP Regulations be amended in order to provide ASIC with flexibility and discretion in regard to penalties.

(i) That the NCCP Act be amended to provide a definition of "financial hardship", relevant to SACC loans, to replace the current inappropriate "substantial hardship".

(j) That the NCCP Act be amended to more clearly provide a discretion, according to affordability, for the lender to refuse a consumer's hardship application.

(k) That the NCCP Act be amended to include "credit repair" companies as entities that should be licensed and regulated, with compliance supervision by ASIC.

(l) That the NCCP Act and Regulations be amended, in particular, Forms 11A and 12A, to ensure a clear message that the Internal Dispute Resolution regime must be referred to by consumers with a complaint or dispute, prior to accessing the External Dispute Resolution regime.

(m) That the NCCP Act and Regulations be amended to ensure that External Dispute Resolution schemes refer consumers who have not accessed the Internal Dispute Regime, back to that Internal Dispute Resolution regime, without fee.

(n) That the NCCP Act be amended to clarify an appropriate role for External Dispute Resolution Schemes that is appropriately limited only to facilitating the resolution of conflict between consumers and lenders, without the continuation of the quasi-judicial powers and ASIC agency responsibilities currently adopted.

(o) That the National Credit Code be amended to remove the comparison rate provisions, due to obsolescence and consumer confusion.

(p) That Section 47 of the NCCP Act be amended in regard to the issue of compensation, to more clearly reflect ASIC's current policy.

(q) That the National Credit Code be amended to remove the "interest" terminology and requirements, in recognition of the SACC permitted fees regime (and MACC annual cost rate regime).

(r) That the NCCP Act be amended to provide consistency with other Commonwealth legislation, clearly permitting the electronic delivery of all documentation prescribed by the NCCP Act and Regulations.

(s) That the National Credit Code be amended to permit the cost of electronic bank statements to be charged to the consumer at cost, over and above the permitted fees and charges.

(t) That the NCCP Act and Regulations be amended to clearly include No Interest Loans and Low Interest Loans as credit contracts requiring regulation equivalent to that applying to SACCs (and MACCs).

(u) That the National Credit Code be amended to remove the anomaly of lenders being unable to take security on SACCs.

(v) That no further anti-avoidance provisions be included in the NCCP Act and Regulations.

3. Whether any of the provisions which apply to SACCs should be extended to regulated consumer leases.

   Recommendation

   The Delegation does not make any recommendations, as none of its supporters are involved in offering the leases as described in the Consultation Paper.

4. All Finance Industry Delegation recommendations take into account competition, fairness, innovation, efficiency, access to finance, regulatory compliance costs and consumer protection.

5. Whether the laws relating to SACCs and regulated consumer leases are appropriate for the current economic climate and whether they will continue to meet Australia's evolving needs.

   Recommendation

   That the current laws relating to SACCs be maintained, subject to the recommendations listed above.

6. Noted, no recommendation required.

7. It is noted that this Term of Reference precludes the current Expert Panel from recommending "*the establishment of a further review(s)*".

   The Delegation does not believe this is an appropriate restriction or is in the best interests of the consumer, given the importance of their access to credit and Government policy in support of a viable commercial small amount/short term lending sector, while the Commonwealth credit regime imposes price control.

8. Noted, no recommendation required.

Recommendations for Treasury topics not specifically included in the Terms of Reference, but canvassed in the Consultation Paper

The Delegation is pleased to provide recommendations on issues that emerged when considering the Consultation Paper, but which were not specifically included in the Terms of Reference.

Complexity:

(a) That a comprehensive edit be undertaken, and restructuring where necessary, of the NCCP Act and Regulations. This reducing the difficulty of navigating the documents, reducing the possibility of misunderstanding and the cost of compliance.

(b) That a continuing consumer education program be undertaken, to encourage consumers to read their mandatory documentation.

Sanctions:

(a) That a review of the current sanctions be undertaken to determine a more equitable and appropriate range.

(b) That the NCCP Act be amended in order to recognise fundamental legal rights for an accused, with particular attention to the examination process.

(c) That the NCCP Act be amended in order to recognise the generally applying legal privilege rules and remove ASIC's power to determine whether or not legal privilege will be acknowledged.

Benchmarks:

(a) That no prescriptive benchmark be adopted, given the concept's failure to avoid debt spirals.

(b) That no particular benchmark be chosen as no existing benchmark has been designed for assessment of SACCs.

(c) That the credit provider be at liberty to design a benchmark to be used purely as a comparative checking facility towards the conclusion of the responsible lending assessment process.

Hyperlink:

That the requirement for a hyperlink to the MoneySmart website be included on the lender's website not be adopted - unless significant and appropriate amendment of the MoneySmart website is undertaken.

Industry commissioned research

CoreData research was commissioned in 2015 by the National Credit Providers' Association (NCPA), and with results generously shared with the Delegation, involved a study of 23 lenders who responded to a detailed questionnaire during the months of July to September.

Further relevant data was obtained from a third public company's ASX submission. The 23 lenders included supporters of the NCPA and/or the Delegation, and included the 2 biggest SACC lenders and an industry representative group of 21 other large, medium and small lenders. There is little doubt that these 23 lend at least 70% of all SACCs in Australia.

Smiles Turner, compliance, communications, management and research consultants have conducted research into the small amount/short term lending industry on a number of occasions since 2002. Major research programs have always included self-completed questionnaires, distributed throughout the industry sector. In addition, major studies involving consumers have been undertaken using a variety of methodologies. This research was referred to extensively in National Financial Services Federation (now NCPA) submissions to Government until 2008. Subsequently, it has been commissioned and referred to in submissions to Government by the Financiers' Association of Australia and the Finance Industry Delegation.

Details concerning year of research and respondent numbers are included in this submission where research results are cited.

PART ONE

INTRODUCTION

While the terms of reference for the Review are relatively precisely prescribed, it would be most unfortunate if the Expert Panel was not provided with an overview of the Small Amount Credit Contract (SACC) lending sector. There cannot be an informed result to a process where the Expert Panel "*is required to examine and report on the effectiveness of the law relating to small amount credit contracts*", as the Terms of Reference present as the "*Purpose of the review*", unless the panel considers contemporary circumstances.

The SACC environment is now:

- economically precarious for the lenders, and likely to be more so commencing next year;
- contaminated by ideologically driven critics who dismiss the relevance of commercial lending;
- threatened by those critics who challenge the acceptability of commercial lenders, with reference to very methodologically unsound, obsolete research attempts, or contemporary attempts that lack statistical validity;
- dominated by media performers espousing an expectation that the Government will fund the not-for-profit sector to undertake all SACC lending;
- often presented with the solution to every perceived problem, by the industry critic, which is to introduce more legislation and regulation without any consideration of regulatory burden, lender cost, or the ultimate impact on the consumer;
- one that has a total not-for-profit lender capacity to lend no more than 2% of total demand, at best;
- one that has a growing number of Australians applying for a SACC;
- one that has lenders who are reducing supply because of the already strict approval regime, and the fact that current margins demand lower default rates; and
- in the front line of a socio-economic crisis of major proportions, involving 800,000 to just under 1 million people who borrow SACCs, with which the Government will have to deal if the Expert Panel and the Assistant Treasurer get it wrong.

It is extremely unfortunate that the Terms of Reference do not provide the opportunity for recommendations associated with the first 3 questions. The Delegation seriously hopes that the Expert Panel and the Assistant Treasurer will closely consider the issues raised in regard to those questions. The current credit regulatory edifice is built on political convenience, with Ministerial attention notoriously uninterested in the detail and a Shadow Treasurer who had a family background of intense dislike for money lenders.

The need for commercial lenders

As the Delegation presented to the two Parliamentary Committees considering the then draft National Consumer Credit Protection Bill (abbreviated), at the end of 2010, given many of their reasons for borrowing and lack of legal alternatives, denial of small amount/short term credit to such people could create a socio-economic disaster. Many support this concern.

The frontispiece of "*Caught Short: Exploring the role of small, short-term loans in the lives of Australians*", Published by the Social Policy Unit, University of Queensland, in August 2012, included the following quote from a "*Financial Counsellor*".

"*It's very easy for a bunch of middle class advocates, financial counsellors, whatever, to say this shouldn't be happening - but walk a mile in the shoes of the people who have no other access*".

The Australian Centre for Financial Studies funded Report, "*Trends in the Australian Small Loan Market*", written by Marcus Banks, Ashton de Silva and Roslyn Russel, School of Economics, Finance and Marketing, RMIT University and released Monday 12th October 2015, under "*Observations*", reported:

a. *"The high demand for small loans is associated with changes in socio-economic circumstances, especially increases in inequality and precarious employment.*

b. *SACC products meet this demand in ways that other current credit alternatives do not.*

c. *The relatively high cost of small loans is a reflection of the higher risks of default in this market.*

d. *The possibility of more affordable small loan alternatives that are priced at similar APR levels to secured loans or credit cards will only be realised through policy interventions and innovations.*

e. *Policy makers and advocates need to be realistic about what can be achieved through tighter regulation of the industry. We suggest that tighter regulation is, at best, one part of the policy options. Lower fee caps may have the unintended consequence of encouraging illegal lending activity, and so other policy initiatives should be trialled*."

On page 40 of the same Report, it was stated:

"*A recognition that any call to eliminate this sector does not remove the need for cash to meet the day-to-day living expenses of a significant proportion of the population... Alternative sources of cheap, readily accessible credit would need to be instituted prior to any regulations that may make the current small loan market unviable. ...regulations that simply address market-based issues in the sector are insufficient. A broader understanding is required that growing inequality and poverty are the crucial drivers for the growing demand for small loans...*".

A study by the Delegation in 2012, and then again this year, revealed that not one major bank offered, or offers, personal loans for less than $3,000. Amongst the major building societies, only two were identified as reluctantly offering loans of similar size to the larger SACC loans.

As noted by Treasury, "*Access to credit may alleviate hardship by expanding a household's options and allowing the household to smooth expenditure during a period of income or consumption shock*" (Treasury Consultation Paper in response to Section 335A, NCCP Act).

As ASIC stated in Report 426, "*Payday lenders and the new small amount lending provisions*", after commenting that other forms of credit are not available, "*there is a need here being met... and it might even be by the right option*".

Complexity and Government policy

The dominant feature of the Review of the small amount credit contract laws (SACC Review) is complexity. As the Expert Panel and Assistant Treasurer may have been advised before accepting their appointments, there are no ideal solutions and none of the stakeholders can ever be completely satisfied.

Former and current Government policy, as previously announced by then Minister Frydenberg in his media statement concerning the SACC Review - and not contradicted by the incoming Assistant Treasurer O'Dwyer - still demands that a viable SACC lending industry segment should exist.

As this submission will present, the current SACC lending industry sector is showing increasing signs of not being viable, even within the current regulatory regime.

None of the Government Ministers, from either side of politics, has suggested that their Government would be prepared to fund the substantial loan book, to satisfy those who would like to see an end to commercial SACC lending, or are promoting policy change - always without any detailed economic research - which would be the result of commercial SACC lending abolition.

Industry viability seriously threatened

The Delegation submission to the Senate Committee in 2010 revealed economic modelling that demonstrated excessive profits were not likely under, what became, the permitted fee regime of 20% establishment and 4% monthly fees (reference).

Since that economic modelling (also submitted to Treasury in 2011) and particularly in the period 1 July 2013 until now, on top of the price cap being fixed the lenders have suffered numerous cost increases. Treasury did not criticise the modelling, or attempt to replace it with Treasury's own modelling, and referred to it in discussions with the then Minister for Finance and Superannuation, the Minister responsible for the credit legislation, Bill Shorten.

Viability still demands:

- gross income capable of paying for credit reports, which cost the lender between $6.70 and $17 each - depending on volume. Under the current regime, this cost cannot be passed on to the consumer. The higher amount represents a $4 increase for small lenders since 2011;
- paying award wages to staff of approximately $25-30 per hour - the average time it takes for the representative to organise a loan for a new customer - plus allow for 32% on top of this to cover employment on-costs. The wage rates represent an approximately $8 increase since 2011;
- paying rent for premises, whether head office space or outlet, which is increasing beyond CPI in every capital city. A Smiles Turner survey of 20 lenders across Australia indicated that rents paid have increased by 20-30% between 2011 and 2015;
- being able to pay for wholesale funds at commercial - <u>not</u> current housing loan - rates. Lenders are not paying around 4%, but charges of 12% to 22% interest for their funds are frequently reported;
- paying for important incidentals, such as bank statement analyses through a commercial bank statement provider, to ensure accuracy and to avoid possible consumer modification when provided manually - at a cost of $2 a statement;
- paying for essential advertising on the internet and other media to which consumers refer. As discussed later, that means lenders are facing a bill of $27 per click for Google Ad Words participation. Although lending prices are fixed by Government, it is the overseas owned, non-payer of Australian company tax, and out of the control of any Government around the world Google - not the lender - who is the price gouger in the current SACC arena. In these circumstances, any suggestion of lenders having to provide the consumers responding to their advertising, with more detail concerning Government messages or alternate borrowing opportunities, would have to involve a contribution by Government or the alternate not-for-profit lenders, to this advertising cost; and
- a return to the business proprietor and investors (family members or other) sufficient to discourage them from moving to another sector of the finance industry (as Money 3 are doing nationally and GE Money did before them, under the former NSW regime), or to another industry sector (as the infamous Amazing Loans did).

The present Government has inherited a regulatory system that was permitted by Minister Bill Shorten, in his publicly stated hope that the commercial industry sector would diminish and be left with just 12 to 14 large lenders for ASIC to easily control. In 2012 the Treasury sent an executive minute to Bill Shorten, notifying him that the proposed "20 + 4" cap on fees and interest would "*allow for the continued viability of some small amount lenders (although others will be required to exit the industry)*" (as noted in the online magazine Banking Day, story no. 1239828657). This regime is currently not allowing continued viability.

The current regulatory regime’s effect is slowly and steadily negatively impacting on the returns of the SACC lending sector to achieve this.

This outcome is in direct contrast to the current Government’s major pro-small business policy. While big lenders have crashed, or are leaving, 80% of those who have gone have been small family businesses.

No Government or consumer advocate has factored in the waiting bikie gangs, already strongly established in lending in south eastern Queensland and Melbourne. No Federal

Government has bothered to talk to the Queensland Police about their chilling evidence presented to the Queensland Supreme Court 3 years ago.

Amongst this evidence was a transcript of an intercepted phone conversation between two senior members of the notoriously unlawful, and very violent, illegal Finks bikie gang. This is a gang that generally demands gaol time as one of the criteria for membership. The two senior gang members, from Brisbane and Melbourne, were discussing their lending and collection methods. The discussion was nothing like that which would be overheard if the police had been intercepting a telephone call between two Australian credit licensed lenders.

In addition, the Delegation is aware of illegal bikie gang representatives, who turn up at lenders' business premises on the Gold Coast to offer their "collection services", wearing business suits that fail to cover their gang insignia tattoos.

Neither the Government nor consumer advocates have factored in the reports of bikie gang beatings of "slow payers" in the Adelaide hills, or Gold Coast hinterland.

Industry Trends

The following business trends and business environment features are associated with the SACC market in Australia.

1. Profitability per loan is declining under the straight jacket of price control and increasing general business costs. These costs have risen from between 20% and 30% since 2011. Small companies are becoming marginal, medium companies are seeing profit reductions across the board, overall online lenders have lost money in 3 out of the last 8 quarters and, if they are making a profit at all, all the big companies have seen that profitability plateau since the final quarter of 2014.

   There is a fundamental move out of SACC "bricks and mortar" lending starting to build momentum in regional and suburban centres around Australia.

   The image of a highly profitable industry sector that can withstand the three pressures of statutory reduction in earnings and increased costs, via more enquiry and verification demands, plus a potential national SACC database, and the forthcoming ASIC industry sector funding costs - is a profound myth.

   The SACC lending industry sector is heading for a reduction in the number of lenders that could be substantial - in excess of 30%, primarily small business owner-operator companies and small to medium company franchisees and licensees (Smiles Turner industry research 2015). There is major supply contraction involving all remaining lenders, as wholesale funders to the SACC lending sector move to more profitable opportunities for their funds and the major banks withdraw their direct debit services (the latter involving Bank of Queensland, Commonwealth Bank, Nab and Westpac to date).

   An Expert Panel recommendation to reduce permitted fees, even ahead of the Assistant Treasurer's decision concerning these, will escalate this withdrawal right at the commencement of the peak Christmas and back to school January/February lending periods. Local MPs will be the first in the Government structure to feel the response.

2. So small are the margins - despite the un-researched hysteria of the consumer advocates and the frequent quickie headline, with media only after today's "sensation" - that the small lender is being squeezed out, with the pace of that process highly likely to increase following the introduction of the ASIC Industry Funding model cost impositions, regardless as to what the SACC Inquiry Expert Panel recommend.

   In this context, it is most important not to ignore the fundamental business survival concept - that it is not gross income or income before or after tax that is frequently critical - it is the margin the lender makes on the gross income that counts.

   Both major lenders, Cash Converters and Money 3, increased their gross income in 2014-15, but Cash Converters still lost $21 million. After noting that only 22% of their overall profit in one 6 month period (to December 31, 2014) was generated by 88% of their loans which were SACCs, Money 3 calculated that non-SACC lending was something like 17 times more profitable and announced that they were withdrawing from the SACC market.

3. The cost of compliance is increasing under the combined weight of:

   (a) the need for constant highly experienced, credit law knowledgeable, expert professional advice, with its associated substantial fees, in response to the complexity and volume of the legislation and regulations applying.

   The statistics are staggering -

   i. The total number of pages of the NCCP Act, including the National Credit Code is 615.

   ii. Total number of sections in these 615 pages - 667.

   iii. Total number of pages for the NCCP Regulations - 352.

   iv. These 352 pages include 198 Regulations, and 13 Schedules that include 22 forms. Three Schedules have 5 key facts sheets, and three Schedules concern content for the prescribed "SACC Government Warning".

   There is far more regulation for an average SACC loan of between $250 and $350, depending on the lender's local (retail shop front) or attracted (internet) demand, than there is for borrowing $1 million to buy a median priced house in much of Sydney or Melbourne.

   (b) the constant need for management and staff training to attempt to keep up with the ever increasing compliance expectations - as they emerge from yet another ASIC report, new version of an ASIC Regulatory Guide, new issue emerging from one of the External Dispute Resolution Schemes' quasi-courts, or interpretations from the latest judicial decision, which ASIC expects the average lender to be across from the date the judge hands down his/her decision.

   To the above credit regulatory regime must be added the management stress and costs associated with other regulatory regime changes. In the last 2 years, lenders have had to accommodate major regulation change associated with the Personal Property Security Register, Privacy Act and Privacy Code, new AUSTRAC regulations and, where relevant, substantial new franchise laws impacting heavily on both the franchisor and the franchisee.

   All generated compliance costs, documentation development costs and training costs, which have never been recognised as eating into any profit, by any consumer advocate spokesperson.

4. There are ever changing, highly subjective, individual ASIC officer interpretations as to what constitutes compliance - that appear to differ between states and even within each ASIC office - such that none of the lenders can “get it right”, but must make expensive alterations in process and/or contracts to satisfy the new demand.

   Evidence of the impact of these costs is now strongly emerging. The SACC business model is well on the way to supply crisis -

   (a) As indicated earlier, online lenders have lost money in 3 out of the last 8 quarters, due primarily to marketing costs and system development and maintenance costs (CoreData industry research 2015).

   (b) Major company performances tell a story:

   i. The once highly profitable Cash Converters lost $21 million last year. Significantly, the company reported an increase in gross revenue, which sends a strong signal to lender critics that they should not confuse revenue with profitability.

   ii. Money 3 has announced that it is totally vacating the SACC market, despite reporting revenue increases to the ASX.

iii. Despite 4 years of trading, Nimble, the biggest online lenders, has declared to the ASX and elsewhere that they have yet to make a profit. This company now faces the cost adjustment of having increased their staff from approximately 100 to just under 200, to satisfy ASIC's demands for a non-automated system. Even with their current moves to run loan administration from the Philippines, these costs, plus the saturated market, could see Nimble collapse, particularly if their US and South African venture capital sources tire of losing money and/or facing increasing chances of not being fully repaid.

iv. Generously UK-backed high profile online lender, PAID International, collapsed into insolvency this year, still owing $900,000 to a total of 6,650 people, under an ASIC Enforceable Undertaking.

v. The 60+ outlet Canadian-owned The Cash Store, collapsed into insolvency last year.

vi. The once highly successful AMX chain of 20+ outlets collapsed into insolvency in 2013.

vii. At least 20 small lending companies, including franchisees or licensees lending SACCs, have exited the market in the last 24 months.

(c) The move to off-shore loan management services in an effort to take advantage of lower cost international neighbours, has already started costing Australian jobs, with many more to go in a relatively tight labour market and with other lenders reluctant to hire in this period of three-Government Review uncertainty and stagnant profitability.

(d) What occurred during the last quarter of 2014, when approval volumes and profitability went flat across the industry sector, is continuing. Cost increases had finally caught up, just as the impact of all the sources of restricted assessment criteria hit the industry sector (CoreData industry research, plus constant anecdotal information provided to the writers).

5. An increase in demand has been significant in recent years, despite flattening out in late 2014 and early 2015.

6. Overall demand has increased in the last 2 years even faster than during the previous decade. During the 2002 to 2012 period, borrowing of amounts that have since been labelled SACCs increased by 18.6% annually, depending on loan delivery method (Smiles Turner industry research 2005, 2006, 2008, 2010, 2011, 2012). The demand increased by 25% between 2013-14 and 2014-15 (CoreData industry research 2015).

7. The CoreData survey respondents reported total demand at $2 million in 2014-15, up from $1.5 million in 2013-14.

8. In stark contrast, supply is already decreasing.

   The total loan book for the broad spectrum of lenders measured by the CoreData 2015 industry survey, including 4 of the 8 largest lenders, was $554 million in 2014-15, down from $667 million the year before.

   This is a drop of 16.9% in supply, in response to a 25% increase in demand measured in dollars.

   This is due to:

   - the pressure to effectively abolish commercial SACC lending by an oppressive regulatory regime, which is having a major psychological impact on small family business participation;
   - fear of the combined impact of the SACC Review, including the potential costs associated with a mandatory SACC national database and the extra costs to be faced under the proposed ASIC industry funding model, to commence 1 July 2010.

   This should have the Assistant Treasurer very worried.

9. That means 400,000 people were rejected for a SACC by the CoreData respondents in 2013-14 and this increased to 700,000 in 2014-15 - a 75% increase in rejections in one year.

10. This is a clear indication that the consumer advocates' presumption that <u>all</u> lenders lend to <u>everyone</u> who applies, is fundamentally wrong.

11. The number of rejections can be expected to increase next year, because Nimble, who was one of the high profile companies who responded to the CoreData survey, for a long period was lending a first-up small loan to almost every applicant. This was much to the annoyance of its compliant competitors, but it was finally called to task earlier this year by ASIC and has since changed its lending model.

12. The total loans outstanding by customer account balance, for both SACC and MACC at end of 2014-15, including all fees and charges plus principal, was approximately $400 million for CoreData survey respondents. Although the correlation between the CoreData 2015 and Smiles Turner 2012 research can only be considered indicative, this figure could indicate a decline of at least 20% at financial years' end 2012 to 2015.

13. Again, demand is expanding but not supply. Smiles Turner's qualitative industry research in 2015 indicates that this is primarily because of:

    (a) the introduction of protected earnings measures for Centrelink benefits borrowers (80% not available for all SACC loan repayments), which commenced in 2013;

    (b) the "2 SACCs in the last 90 days" presumption of unsuitability, commencing 2013;

    (c) the "SACC default on application day" presumption of unsuitability, commencing 2013;

    (d) greater clarification and increased assessment expectations derived from the new versions of ASIC Regulatory Guide 209, particularly the most recent November 2014 version;

    (e) The Cash Store court case judgement and industry newsletters reporting on the Fast Access Finance and Channic trials, increasing lender wariness and toughening lending policies;

    (f) continuing strict and determined advice from compliance advisers; plus

    (g) tighter lending policies as costs squeeze margins, increasing the number of successful loans that are necessary to break even, after a default, meant lenders were more risk averse.

14. The impact of these factors has been consistent for 2 years. The number of loans advanced in each recent quarter has declined in all 8 quarters surveyed by CoreData.

15. As detailed above, there are now higher rejection rates, with larger lenders currently rejecting 30% of applicants and this increasing to rejection rates of 40% to 50% for smaller lenders.

    This CoreData 2015 information is supported by current Smiles Turner industry research that indicates companies, other than the very high profile and 2 of the 3 ASX listed companies, have tougher assessment criteria and reject considerably more of the applicants than do these 5 larger companies.

16. Again, while the correlation between the CoreData 2015 and Smiles Turner 2012 industry research can only be considered indicative, the number of customers in the market continues to be at least 800,000 (Smiles Turner presented a figure of 800,000 in 2012, CoreData presents figures of 801,000 in 2013-14 and 988,000 in 2014-15).

    That means adverse recommendations from the Expert Panel could threaten access to credit for up to at least 800,000 people.

Increase in employed applicants

Associated with this cost crisis and plateau effect, has been a change in the mix of applicants and approvals. People on benefits have declined as a proportion of total consumers and the market is increasingly catering to employed borrowers. Preliminary analysis suggests:

1. The 20% rule for Centrelink benefits recipients and/or increasingly more conservative attention to statutory assessment requirements, as they become better defined by court decisions and compliance advisers offering information and training that encourages a more careful approach, is having a significant impact. The challenge for the Government is the increasing pressure for Centrelink advances, which are distorting cash flow projections for Centrelink budget funding.
2. The demand for working class, and now lower middle class, borrowing of small amounts, short term, is growing as the economy worsens (for them).
3. An example of the worsening economy is the growing unemployment in South Australia, which is now at 8.1%, resulting in credit issues such as the record numbers seeking assistance from the Emergency Electricity Payment Scheme.
4. The excessive house price increases over the last few years are starting to produce the mortgage stress that economists predicted, and the need to supplement household income when specific periodic or unscheduled bills are received. The Expert Panel and the Assistant Treasurer cannot overlook:

   (a) Westpac's October 2015, 20 basis points increase in its home loan mortgage rate;

   (b) Australia's dependence on overseas finance from countries now facing their own difficulties;

   (c) the looming possibility of a contraction of generally available credit, with an associated cost increase; and

   (d) the fact that at least 50% of all banks' lending is tied up with the property market, tipped to move into a general "state of correction" in a matter of months, but already in a severe state of correction in regional centres such as Townsville.

   (Source: ABC 7.30 Report, 15.10.15)

   All of the above will fuel increasing demand for small amount/short term loans.

   This general economic environment is particularly disturbing when media reports are circulating that indicate 2.69 million Australian households, representing 31.8% of all households, are classed as financially stressed (News Limited, journalist Franck Chung).
5. Alternative legal small amount/short term lending sources continue to be unavailable.
6. People are abandoning credit cards, to avoid the never ending repayment of minimum amounts trap, or have “maxed out” on their cards and need other sources of short term funds.

The Delegation is concerned that the thrust of regulatory preference, indicated by certain content in the Consultation Paper, is for longer and larger loans.

This is incompatible with the consumer who seeks the safety net provided by a short term loan when unexpected expenses occur, such as a refrigerator repair, or car registration, or all the bills coming in at once. They see their SACC borrowing as an opportunity to address a temporary cash flow problem.

This type of consumer is absolutely not interested in being forced into borrowing more and longer, paying more permitted fees in total and being at greater risk of default, because there is a regime in place limiting their borrowing to only a certain number of loans per prescribed period. They demand SACC loans of primarily $250 to $300, with the opportunity to pay them off quickly.

Significantly none of the organisations advocating a longer and larger loans regime has ever conducted research to find out what the SACC consumers think of their plans.

Limited attention to lender costs

The current regulatory construct involved a consultation process during which only one stakeholder, the Finance Industry Delegation, presented economic modelling to deal with the development of legislation and regulation that was about controlling dollars and cents.

In this context it is significant to note that neither the Minister's Explanatory Memorandum, nor the Regulation Impact Statement, included any cost consideration regarding lenders associated with the new regime. At page 41 of the RIS it simply stated "*the actual cost of providing these loans across the industry has historically been difficult to ascertain, and is subject to a high degree of variability. Costs will depend on the efficiency and scale of the business and the amount and the term of the loans*".

Apart from noting that Cash Converters, in its response to the Government Green Paper, titled "*National Credit Reform. Enhancing confidence and fairness in Australia's credit law*" (July 2010), had indicated that the average cost per $320 loan was $76.07, the RIS noted the NAB's small loans pilot report and quoted the statement, "*It is not possible to make a profit and legally operate with the 48% per annum cap for loans of $1,700 or smaller, for a portfolio of 3,000 loans or less, for loan terms of 1 year or less*".

The RIS continued on page 41-42, "*Further, to make a small profit on an average loan of $605 the lender would need to write 165,000 loans a year - which we consider is well beyond the vast bulk of the industry, if it is achievable by any...*".

There exists a socio-political dream that a borrowing cost structure must be enforced that means lenders earn nothing, or usury is being permitted. Meanwhile the lenders continue to service the needs of 800,000 to 988,000 Australians (we note current consumer advocate media coverage indicates that up to 3 million Australians could be potential customers). Without the commercial small amount/short term lending industry, and with the banking industry refusing to become involved in the market, these Australians would face legal credit exclusion.

Ironically, those who would impose a free, or far below lender costs borrowing regime, insist that access to credit for free - or at well below cost - is the right of every Australian.

Associated with this socio-political dream is a failure to understand or recognise that attempting to impose a regime that reflects bank home loan rates, involves totally invalid comparisons between a 25 year fully secured home loan for $800,000, with an 8 week totally <u>un</u>secured loan of $350. Valid comparison explain why none of the banks lend SACCs, and have not done so for over 10 years.

None of the advocates of this socio-political dream, or industry sector critic, has ever been known to agree to putting their own money up to fund a loan book without security on the loans to be offered, and without any realistic economic return - in order to demonstrate support for their position.

There is always un-researched hysterical media coverage which, on occasions, generates ignorant 7 second media grabs and political and 'pro-tougher legislation' headline responses.

None of the populist media has ever considered lender costs, or explored the total inability of the not-for-profit sector - with their limited loan book funds, lending generally restricted to larger loans of over $700, for a limited range of specific purposes, and assessment and approval times measured in weeks, when the vast majority of consumers want decisions on the day of application - to take over even 10% of the commercial lenders' loan books.

Nationally, approximately 620 SACC lenders are under huge regulatory stress from complex and often less than precise, badly edited legislation and regulation who, at considerable expense, are attempting to be compliant. This while they watch some of the biggest lenders conduct business in a fundamentally non-compliant manner, for long periods, with apparent ASIC approval.

Those seriously attempting to be compliant are Australian owned and largely Australian funded private companies. Those favourably treated or ignored by ASIC are two of the public companies and at least three of the overseas funded and/or owned high profile companies.

Demand for SACCs is not going away but, as with any Government price control regime, costs must be realistically recognised to fulfil the Government's policy commitment of a viable commercial SACC lending sector.

Repeat loans

Like all well run businesses, small amount/short term lending companies set out to attract repeat business. In the case of the small amount/short term lending sector, this does not mean an opportunity to earn excessive profits.

Such an assessment would be very naive.

Smiles Turner research in 2010 indicated that 28% of lenders' consumers were repeat consumers. That means, under the Commonwealth regulatory regime introduced at the time, and since effectively massively expanded, while there may not be any marketing costs directly attributable to the returning consumer (which is an obvious financial benefit to the lender), the lender still has to undertake a rigorous suitability assessment of every application. Albeit if it is a consumer returning within 90 days of the last assessment, some lesser effort is allowed.

In addition, the staff time allocated for all the paper work associated with the loan application still applies, the lender still has to pay all fixed costs associated with the business and still has to allow for the loan administration costs and the possibility of bad debt due to consumer circumstances changing after the repeat loan is advanced.

Rejection rates

Consumer advocates contend that all lenders accept every application. While the Delegation does not deny that lending policies associated with one of the public companies, one of the largest online companies now under ASIC encouraged fundamental change, and a high profile company that went into receivership earlier this year - none of whom have ever been Delegation supporters - may have encouraged that view, this is absolutely not the case for the industry sector as a whole.

Apart from the fundamental consumer protection provisions in the National Consumer Credit Protection Act 2009 (NCCP Act) that strongly mitigate such a policy, there is also the issue of massive bad debts being created by such a policy.

The recent history of the industry sector reveals that at least 3 high profile companies have gone to the wall, substantially because of lending policies involving too lenient assessments.

CoreData 2015 industry research indicates an average of up to 4 applications are rejected for every 10 received. This is broadly consistent with Smiles Turner research undertaken in 2012, but is less than a random selection of reports by Delegation supporters during the preparation of this submission, where rejection rates of up to 73% were reported.

Not-for-profit lenders and coping with increased numbers

None of the not-for-profit organisations, or any consortium of such organisations, has the capacity to handle responsibility for more than 2% of the demand - even if the government was to give them the loan book funds.

Their challenges include:

- a lack of trained, non-volunteer personnel;
- lack of integrated loan management systems owned by the organisation;
- some limitations on national diversity of lending outlets, rarely open all business hours, or with trained staff always available;
- lack of internet lending experience;
- lack of experience assessing loans on the day, rather than taking up to some weeks; and
- lack of bad debt management and control experience.

The Delegation is unaware of any consumer advocate organisation recommending the prohibition of commercial lending of SACCs be included in the NCCP Act. However, there appears to be a concerted effort to campaign for increasing compliance legislation and regulation, together with a reduction in permitted fees, that would effectively cause prohibition. This prohibition would be contrary to Coalition Government policy concerning SACC lender viability and contrary to Coalition small business policy.

If prohibition was to occur, however created, a careful analysis of the ability of the not-for-profit sector to replace all the commercial lenders would have to be undertaken.

In March 2014, J. All and M. Banks published their study, "*Into the mainstream, the Australian Payday Loans Industry on the Move*", Economics Finance and Marketing School, RMIT University, JASSA, The Finsia Journal of Applied Finance. Marcus Banks, a respected academic, has been involved in a number of studies commissioned by the consumer advocates.

This study estimated that 1.1 million people in Australia, constituting 15% of the adult population, took out an average of 3 payday loans per year. These figures are broadly supported by lending industry commissioned research.

In 2012 a Smiles Turner survey of 1,906 borrowers indicated the average number of loans per year was 2.4. As indicated elsewhere in this submission, the estimated number of small amount short term borrowers at the time was 800,000.

In 2015, the CoreData survey of 23+1 companies, including "the big four", are estimated by CoreData to make up 88% of the industry SACC loan book.

While Smiles Turner industry analysis suggests the respondents' loan book percentage may be lower than 88%, there is no doubt about the number of borrowers. The respondents to the CoreData research program indicated that there were 801,000 consumers in 2013-14 and 988,000 consumers in 2014-15.

These consumer numbers are consistent with Smiles Turner earlier research and the statistics on demand growth with research in 2006-7 that indicated at least 500,000 borrowers for the entire sector and, Smiles Turner research in 2012, which indicated approximately 800,000 borrowers for the entire sector.

Good Shepherd Microfinance, a very worthy organisation involving 247 accredited community organisations lending from 670 locations nationally, approved 23,000 No Interest Loans of up to $1,200 in 2014 (Source: "*Trends in the Australian Small Loan Market*", Banks, de Silva and Russell, School of Economics, Finance and Marketing, RMIT University October 2015).

There are two other not-for-profit organisations, Fair Loans Finance and Foresters Community Finance who the Delegation understands, together, lend less than 2,000 loans a year. Larger company supporters of the Delegation are <u>each</u> lending that many loans in 5 to 8 weeks.

No Interest Loans (NILS) are offered from $300 to $1,200, for white goods, some furniture, some medical and dental services, educational essentials such as computers and text books, and "*some other items as requested*". This is a relatively limited range when the reasons for borrowing, offered by consumers, are considered (see detailed analysis later in this submission).

To qualify for a NILs, a borrower must have a Healthcare card, a pension card or be on a low income, have resided at their current premises for more than 3 months and "*show a willingness and capacity to repay*".

This total annual Good Shepherd affiliated lending meant an average of 63 loans for each of their 365 sites over a year. Smaller company supporters of the Delegation report providing that many loans in under 2 months.

The Good Shepherd Microfinance publish that the organisation has "reached over 170,000" people since commencing its lending programs in 2003. That is an average of 14,166 people per year.

This number constitutes 1.43% of the consumers who borrowed from the 23 CoreData respondents in 2014; or 1.77% of the estimated borrowers in 2011-12 indicated in the Smiles Turner 2012 research; or 1.28% of the 1.1 million borrowers considered in the All and Banks paper.

In 2013, Good Shepherd Microfinance reported that their Low Interest Loan service, StepUp, created a national average of 755 loans per year, since commencement in 2004.

The loans are for $800 to $3,000. The Delegation recognises that the StepUp loan product is not a SACC when the amount lent exceeds $2,000. However, the volume lent and criteria have important indicators for the Expert Panel and the Assistant Treasurer to keep in mind.

As the April 2013 report, "*StepUp Loan, A little help goes a long way: Measuring the impact of the StepUp Loan program*", prepared by The Centre for Social Impact noted, "*It is an intermediate loan scheme that sits between the No Interest Loan Scheme (NILS) and mainstream credit*", is provided with NAB assistance at a very generous small interest rate and, as with NILs, "*can only be used to purchase essential household goods and services, such as motor vehicle purchases and repairs, white goods, medical and health expenses, computers and education*", and "*To be eligible... clients must hold a current Centrelink Healthcare Card or Pension Card or be eligible to receive Family Tax Benefit Part A. They must also have resided at their current address for 3 months*".

These purposes for borrowing are just a small sample of the many reasons indicated by borrowers from commercial lenders (see detailed analysis later in this submission).

Significantly the low income and pensioner requirements, for both the NILs and StepUp loans, would have excluded 59.5% to 64.5% (depending on quarter) of total consumers who borrowed from the CoreData respondents - as they were employed.

The 2013 report indicates that 6,800 loans, for a total of $19.3 million, had been lent from 35 sites over the 9 years of operation up to that point. That meant an average of 756 loans per year, or 21.6 loans per year from each of the 35 "sites". The smallest regional lender supporting the Delegation lends that average Good Shepherd site volume in just one month.

As indicated with the numbers for the various loans listed above, the three identified not-for-profit sector lenders lent approximately 26,500 loans in 2014. The CoreData research respondents, in 2015, reported that they had rejected 700,000 loan applications.

The CoreData research indicated that the lenders who responded lent $667 million in 2014-15, up from $554 million in 2013-14 for SACC loans. Smiles Turner enquiries in 2015 indicate that lenders who did not respond to the CoreData survey lent at least another $190 million in 2014-15. The combined total approaching $857 million.

These numbers are consistent with Smiles Turner's extensive industry sector research commissioned by the Delegation in 2012, which revealed 800,000 consumers were borrowing $1.2 billion that year. This included SACC, MACC and all other small amount/short term loans.

In 2011 the Federal Government pledged $18 million, over 3 years, to Good Shepherd Microfinance, which the Delegation understands covered both SACC and MACC lending. This assistance was in addition to funding assistance and administrative help from NAB and other sources, including public donations.

The $6 million Government funds provided to Good Shepherd Microfinance in 2012-13, contributed to 23,000 loans. In the absence of any available statistics concerning contributions to the low interest Step Up loans and on the assumption that all NILs loans were repaid, this would indicate a Government subsidy of over $260 per loan.

That means the $6 million Commonwealth grant would have provided loan funds for 0.7% of the total annual 2014-15 commercial industry loan book.

Calculated on a very simple subsidy per loans basis:

If the Good Shepherd Microfinance Government subsidy was to be applied to the commercial sector, the annual cost to the Federal Government would be $390 million.

If Government funds were to be allocated to a loan book funding pool, assuming - very optimistically:

- an average loan term of 17 weeks, reflecting both CoreData and Smiles Turner research in 2015;
- all funds lent 100% of the time, with cash flow from loan repayments immediately applied to new loans;
- all loans 100% fully repaid, without any defaults during the term, providing even cash flows; …

to fund the entire Australian demand via Commonwealth grants to the not-for-profit sector, conservatively, the Federal Government would have to increase its current budget allocation by approximately 20 times, to approximately $120 million. Introducing reality into the above assumptions, including not all funds being immediately lent, defaults and bad debts, could add another $20 million to that amount.

As the Delegation presented to the Parliamentary Committee undertaking their enquiries into the then proposed NCCP Bill in 2010, in addition to any funding for loan books, the Federal Government would also have to invest substantially in not-for-profit lender infrastructure before they could replace the commercial lenders. An indication of the cost of this investment is the current fit-out costs for a secure retail lending outlet of $126,000. Few of the current not-for-profit lenders' premises would meet the High Street, or equivalent, retail location requirements for commercial SACC lending and even fewer the security standards essential for retail lending at the loan volumes, and associated cash transactions, involved.

Apart from the impact on a Commonwealth budget already under considerable stress, this would also effectively involve a complete upheaval to Coalition Government policy and a return to the nationalised banking policies for the now non-ADI personal loans sector of the Chifley ALP Government, which contributed to that government's defeat in 1949.

Success with recommending the effective abolition of commercial, small amount/short term lending, accompanied by a failure to secure the necessary $120 to $140 million Commonwealth funding, will lead to financial exclusion for the majority of the 988,000 to 1.1 million Australian consumers of such loans (see statistics on the very limited availability of alternatives later in this submission).

The Centre for Social Impact, that prepared the StepUp Loan report, acknowledges that "*financial exclusion* (is) *a key policy issue in Australia*" (page 10). 988,000 to 1.1 million votes at the next Federal election could also be a key political issue.

Beware the case study

There are always highly emotive, poorly researched (if at all), "pro-consumer" assertions, evidencing a total commitment to the "nanny state" presented by consumer advocates. Many use individual examples that they assert to be typical throughout the sector. However, on closer examination, these examples frequently reveal a less than impressive side to the "poor innocent victim" than the consumer advocates are presenting.

It is a continuing source of concern that consumer advocates repeatedly present "case studies", or single out particular consumers for media or legal case attention, without a comprehensive presentation of the particular person's unimpressive borrowing background and repayment behaviour.

One stark example of this is the "pensioner" used in a Queensland newspaper article as having been a "victim" of payday lenders, who turned out to be a retired debt collector who knew exactly how to work the system and had a string of unpaid lenders seeking loan repayments.

Another example is the couple who borrowed for essential house repairs, used the money for a holiday in the Philippines, and then used the services of NSW Legal Aid and the NSW Tribunal in an effort to avoid repaying the loan.

At no time does the Government or the consumer advocates ever acknowledge that the consumer, as a mature and generally very experienced adult, has to take some personal responsibility for their borrowing actions.

When considering these case studies, it is relevant to acknowledge that there is a pre-existing straightjacket of complex regulatory construct, which was founded on political convenience.

This straight jacket and the anti-SACC lender “movement”, with participants constantly trying to justify their generous government grants, has grown up around a regime that encourages dishonest behaviour by consumers. National “responsible lending” has introduced an era where less than honest borrowers have opportunities to exploit at every turn.

That means a nation of small loan consumers who now:

- do not have to read the lender's mandatory contracts they are signing;
- need not follow through with a commitment to a legal contract;
- can claim “hardship” at every opportunity - regardless of the truth of the situation;
- can exploit a lender-punitive sub-regime of External Dispute Resolution Scheme costs;
- with their champions, exploit automatic “systemic issue” escalation with every flimsy allegation; and
- with their consumer expensive “credit repair company” allies, use crippling system-created cost blackmail to create a total lie within the credit reporting regime, while placing lenders at threat with Credit Reporting Body fines and prosecution for removing bad credit listings without justification.

PART TWO

THE LEGISLATION, REGULATION AND GENERAL CONTEXT OF THIS SUBMISSION

The Treasury Secretariat, Expert Panel and Assistant Treasurer are strongly encouraged to carefully consider the fundamental problems associated with the current legislation and regulation. It is also important to recognise the extensive consumer protection already included in the NCCP Act and associated Regulations.

Significant consumer protection already available

This protection includes:

- Accounts provision at no cost.
- Advertising and marketing conduct rules.
- An assessment regime, including detailed criteria prescribed for every credit application and with opportunity to obtain a free assessment report (see details listed below).
- Australian credit licenses (mandatory) demanding substantial documented awareness of all the consumer protection issues and measures, and providing an ultimate penalty of industry exclusion for the non-compliant.
- Authorisation regime for credit representatives.
- Banning orders for ASIC to use.
- Brokerage and similar fees essentially prohibited.
- Centrelink benefits recipients protected earnings provisions.
- Contract refinancing discouraged, with establishment fee prohibited.
- Compensation arrangements for consumers (PI insurance or approved alternatives) in place.
- Compliance certificate regime on an annual basis.
- Contract alteration controlled.
- Contract content substantially specified, providing detailed contracts.
- Contract copy provision.
- Contract content and expression standards prescribed.
- Contract term conditions.
- Contact termination opportunities clearly and helpfully prescribed.
- Court review of unconscionable charges.
- Court review of unjust contracts, with wide discretion.
- Court imposed remedies of substantial flexibility to suit the consumer, with ASIC empowered to represent the consumer.
- Credit amount limitations.
- Credit amount recovery limitations, providing a cap on default fees collected.
- Credit guides to assist understanding and with reference to free complaint services.
- Default interest controls.
- Default notices and a multiple procedure, providing substantial information and offers of help.
- Debt collection strict rules.
- Direct debit default notices.
- Early termination opportunity.
- External dispute resolution - free service.

- Fee disclosure requirements, ascertainable and unascertainable.
- Fees prohibited.
- Government warnings, comprehensively prescribed, including alternative sources of funds, located at premises entrances, inside premises and on websites.
- Hardship application regime.
- Information statement provision.
- Internal dispute resolution - free consumer service.
- Legal advice prescription.
- Management and staff training prescribed.
- Permitted fees caps.
- Postponement of recovery action applications.
- Pre-contractual statement copy provision.
- Prohibited monetary obligations detailed.
- Statement provision obligations at no cost to the consumer.
- Suitability of loan basic test.
- Offences relating to misleading consumers (supplemented by ASIC Act provisions).

Activities required to satisfy the continuing mandatory assessment regime

To satisfy the above statutory requirements concerning a compliant responsible lending assessment and associated activities, the lender has to address the following:

- Facilitate the consumer's opportunity to easily read the Government Warning statement.
- Provide a Credit Guide.
- Provide (and explain) a Privacy Consent Agreement for signing.
- Verify the applicant's identity.
- Ascertain the applicant's requirements and objectives.
- Obtain information about the applicant's financial situation, including immediately preceding 90 days worth of bank statements.
- Verify information about the applicant's financial situation, including obtaining a credit report, according to company policy.
- Enquire about the applicant's past and current borrowing history, in particular their history of borrowing SACCs.
- Where a Centrelink benefits recipient, calculate the protected earnings amount.
- Review income and expenditure details and calculate the "buffer" associated with discretionary income.
- Make an assessment, based on the above, as to the suitability or unsuitability of the applicant to obtain credit.

All of the above has to occur whether or not the conclusion of the process is an income earning loan being granted, a consumer who subsequently defaults resulting in the lender losing some or all of the loan funds, or an applicant who is rejected as being unsuitable under the Commonwealth credit regime, which doesn't generate any income for the lender, despite incurring the cost of attracting the applicant to make an application and the time spent making the assessment.

Mandated post-assessment activities include:

- Provide the applicant with an Information Statement.
- Provide the applicant with a Pre-contractual Statement (including the Financial Table).

- Present and explain the Credit Contract.

Lenders at a disadvantage

It must not be overlooked that the current unsatisfactory National Consumer Credit Act-regulated regime inflicts the following on lenders:

- A poorly arranged and indexed NCCP Act and Regulations.
- An Act and Regulations that created numerous longer alternative titles for financial roles that have been in existence for over one hundred years, e.g. "authorised credit representative", instead of "broker" and "credit provider" instead of "lender".
- Contradictory legislated requirements concerning "interest", due to a lack of overall editing for consistency when the 2012 amendments (commencing 2013) were prepared.
- Reliance on ASIC Class Orders for clarification and contradiction with legislated provisions.
- Oppressive creation and maintenance of “red tape”. Mandated credit and associated documentation that creates up to 18 pages of paperwork, which none of the consumers want to read, but every lender faces heavy penalty if they fail to provide.
- The opportunity for highly subjective interpretation of the NCCP Act and associated Regulations, due to lack of precision in their drafting by, what appears to be, increasingly inadequately trained ASIC officers who have been provided with relatively senior positions. This as ASIC suffers a talent drain as a result of the 4 internal upheavals over the last 6 years and inclusion under the Commonwealth Public Service Act (and a possible fifth upheaval, following the current ASIC Capability Review).
- Total removal of any responsibility for a consumer's own actions, without any mention of consumer liability in the whole of the NCCP Act and associated Regulations.
- The opportunity for unlicensed and totally unprincipled, so called “credit repair” companies to significantly undermine the credit reporting system, while blackmailing lenders to break the law concerning unfounded and inappropriate removal of adverse credit listings with credit reporting bodies. This is because neither the NCCP Act, nor the associated Regulations, attempt any regulation of these parasites, who frequently charge the consumer more than the amount the consumer owes the lender, for services that are provided for free by many not-for-profit financial counsellors, or what could be considered by honest use of the Internal Dispute Resolution mechanism.
- The opportunity for External Dispute Resolution Schemes (EDRs) to exercise a quasi-judicial function, supposedly under the supervision of ASIC, to which lenders must belong under the NCCP Act. These EDRs, which assume both ASIC and the equivalent of judicial power, operate totally at the lenders’ expense and without lender representation on their boards, operate without lender consultation on any rule change, and reach adverse to the lender decisions without rules of evidence, or without any opportunity for the lender to personally address “the court” and cross examine the consumer. This in a conflict of interest environment of financial advantage for the EDR if they escalate the dispute, or declare an issue to be a “systemic issue”, thereby providing an opportunity to increase their fees from under $200 to several thousand dollars. Despite this sanction by Government, they are not obliged to report their profitability, or what they pay their CEO/Ombudsman, to anyone outside their private boards.
- A high cost compliance burden for the lenders, with the need to engage expensive compliance advisers at every turn due to the complexity of the legislation and challenges of interpretation.
- No scheduled review of the Medium Amount Credit Contracts and All Other Credit Contract categories, in which many SACC lenders are involved as a business policy, or because they must be prepared to offer the full range of small loans in order to compete. This regime also has rigid price controls in place that effectively set the market price, no matter what costs the lenders face.

PART THREE

WHY DO PEOPLE BORROW SACCS?

Smiles Turner general consumer research in 2008, 2011 and 2012, supported by a selected small lender study earlier in 2015, provides a relatively consistent list and weighting of reasons people borrow small amount/short term loans known as SACCs.

While there is some variation, study to study, the results are broadly constant, or consistent with those discovered by the Smiles Turner study of over 1,900 in 2012.

The only difference is, following The Cash Store judgement and the inclusion of new content in ASIC Regulatory Guide 209 in November 2014, consumers are now being asked to define “bills”. It has been discovered that consumers who are first nominating “bills”, on further questioning indicate that these relate primarily to one or more of the expenses where an invoice is issued, almost always utilities and telephone, and occasionally rent, school expenses and demands for credit card payment.

Demand dynamics

Industry research undertaken in March, April and May 2011 by Smiles Turner, revealed that:

- there were approximately 1.5 million payday and microloans a year (now defined as SACCs, MACCs and AOCCs); and
- there were 750,000 consumers borrowing funds;
- borrowers of smaller loans, on average, borrowed 2.4 times per year;

Research in May and June 2012 revealed that:

- 630,000 of these borrowers had nowhere else to go; and
- the number of borrowers had increased to approximately 800,000.

Research and industry contact in 2015 reveals most Delegation supporters, who also lend to Centrelink benefit recipients, are reporting increasing lending to employed consumers. This trend is confirmed with the CoreData survey indicating a recent increase in respondents lending to employed consumers from 59.5%, to 64.5% just two quarters later.

The CoreData research discovered that, over all 8 quarters surveyed, an average of 6.8% of contracts were approved where the applicant consumer already had an existing SACC.

Why do they borrow?

A 5-state Smiles Turner survey of 678 borrowers in November 2010 and the national survey of 1,906 borrowers in May/June 2012 revealed the following statistics:

The purpose of the loan	Nov 2010	May/June 2012
Bills	20.6%	22.35%
Finance/repaying other loans/cash	3.8%	8.99%
Food	1.8%	3.57%
Shopping/household	2.2%	5.66%
Living costs	8.4%	
Car repairs & petrol	10.0%	All vehicle costs 16.15%
Car rego & insurance	3.1%	
Vehicle purchase	4.4%	
Boat expenses	1.8%	
Gifts	0.9%	
Children	1.6%	2.04%
Birthdays	1.5%	1.20%
Rent/bond/moving expenses	4.9%	4.03%

Business	1.0%	0.26%
House repairs	3.1%	
Entertainment	1.0%	
White goods/furniture	4.3%	
Medical/dental	3.0%	3.88%
Holidays & travel	7.5%	5.24%
Pets	0.3%	
Utilities bills & council rates	2.7%	
School fees & uniforms, etc	2.6%	0.62%
Legal fees	0.7%	
Clothes	0.3%	
Funerals	0.7%	0.42%
Family emergency	2.0%	1.94%
Personal	6.0%	8.09%
Other	3.9%	15.00%

Emergency and urgency dominates

The 2012 survey revealed that 68.7% borrow in an emergency situation and 85.8% are borrowing as a "matter of urgency".

Alternative sources of funds

Over the last decade, Smiles Turner research has measured between a low of 65.5% and a high of 81.6%, the number of respondents who indicated they had nowhere else to go, with an average 70.57%.

In 2007, Smiles Turner's consumer survey of 535 borrowers revealed 79.7% had nowhere else to go to borrow, or source funds, with friends (4.1%) and family (3.7%) nominated as the most frequent alternatives. These proportions have remained relatively consistent in later surveys.

In the 2011 survey of 1,305 borrowers -

Where will you go if lenders are closed down?	**%**
Nowhere to go	70.49%
Extension of bill payment	2.23%
Government assistance	1%
Centrelink	0.9%
Pawn broker	0.5%
Charity	0.3%
Other optimistic assessments:	
Bank, building society, credit union, finance companies	11.5%
Friends and family	7.7%
Another lender	1.7%
Other (incl. crime, prostitution, illegal lenders)	3.68%

Note that 11.5% of respondents were optimistic, in hoping that a bank, building society, credit union or finance company would be available. However as indicated earlier, banks, building societies and credit unions will largely not be available - they moved out of lending to this sector 10 or more years ago and have no intention of returning.

In the 2012 survey of 1,906 borrowers, 83.31% reported that they had nowhere else to go. This is the highest percentage recorded to date. Significantly 54.83% reported that, when they last tried to get funds from the alternative they had nominated, they had been rejected.

Criteria restriction - NILs and StepUp loans

The opportunity to seek an alternative from the non-commercial lending sector has significant constraints.

No interest (NILs) and low interest loan (Step Up) schemes rarely lend for more than 20% of the above consumer nominated reasons. In 2012, 27% (the highest in 10 years of research to that date) of the reasons for borrowing may have satisfied such a scheme's criteria but with a 90%+ rejection rate, 4 to 8 weeks wait for an urgent or emergency loan and very limited funds for lending, they cannot be considered an automatic alternative. In addition, Smiles Turner contact with a range of NFP lenders in April 2012 revealed that none of them were interested in taking on the responsibility of becoming a major lender.

The Delegation appreciates that only the very worthy Good Shepherd Microfinance organisation has indicated interest in adopting the role of a major lender over the last 12 months.

Borrowing circumstances

In 2012, of the 1,905 consumers who responded:

- 68.7% reported that they borrowed for emergency purposes and 85.8% borrowed in urgent circumstances (as indicated above).
- 24.29% had accepted help from a charity in the past.
- 76.865 would not feel comfortable if they had to go to a charity in the future.
- 36% had repaid a utility debt under a hardship arrangement in the past.
- 39.6% had pawned something in the past.
- 71.09% did not have anything suitable to pawn on the day of the survey.

Attitude to Government intervention

In 2012 -

- 98.8% <u>did not want</u> the Government to close down the lender from whom they were borrowing on the day of the survey.
- 93.45% <u>did not want</u> the Government telling them whether or not they could borrow.

PART FOUR

RESEARCH REPORTS AND THE CONSULTATION PAPER

The Consultation Paper's foundation may be fundamentally compromised

Unsound justification for approaching a review means unsound issues proffered for consideration, or bias in the preliminary overview - before key questions are presented. This significantly threatens to create bias in any recommendation outcome, leading to government policy initiatives that are either fundamentally wrong or perverse. This also results in distortion of the market in potentially unintended ways that, on this occasion, will be very adverse to consumer interests.

Selection of obsolete reference materials

The selection of obsolete reference materials in the Consultation Paper has the propensity to compound the dangers outlined in regard to considering the "Caught Short" Report and ASIC Report 426 as having any real contemporary credibility (see discussion below).

The inclusions under the subheading "*Role and characteristics for small amount lending*" are most unfortunate.

For example, the statement that "*up to 25 per cent of those borrowers having incomes below the Henderson Poverty Line*" is substantially obsolete, because:

(a) applicants now have to meet the substantial "not unsuitable" criteria mandated by the National Consumer Credit Protection Act and associated Regulations, plus relevant ASIC Regulatory Guides', regime. This demanding regime was not in existence at the time of the submissions to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry;

(b) the Henderson Poverty Line has been rejected by ASIC as a valid measure, except as a comparative opportunity after all other assessment procedures have been employed (Regulatory Guide 209, November 2014 version); and

(c) the source of the 25% estimation was fundamentally flawed. It came from a methodologically unsound consumer advocate submission that included questions to a non-random selection of consumers from a population that was not the general borrower population, but was a population that was relatively easily accessed and primarily consisted of economically disadvantaged people.

"Caught Short" and ASIC Report 426

The Delegation has never before included a separate analysis of the various research reports, known to have been prepared by non-lenders and presented to particular inquiries, in any of its numerous submissions to Government.

However, because of the significance of the SACC Review to most of the Delegation supporters and after reviewing the quality of the non-lender research in question, the Delegation resolved to make an exception on this occasion.

The Delegation considers below the two reports referred to in the Consultation Paper and two other research efforts.

The inclusion of both ASIC Report 426 and the "Caught Short" Report in the Consultation Paper, contaminates the introductory comment to very important questions. The Delegation considers that it is critical to address this contamination from the outset, before presenting the Delegation's answers to the Terms of Reference of this Review.

Significantly, the Consultation Paper's presentation of these two Reports as being relevant studies, is contrary to the intentions of the then Minister Bill Shorten, when the 2015 Review was mandated.

The Minister's comments at the time - both in and out of the Parliament - and paragraph 4.39 of the Revised Explanatory Memorandum prepared for the Senate, prior to debate on the NCCP (Enhancements) Bill, all indicated that the current review would be regarding lender action and its interface with the legislation over the whole of the two years following the commencement of the NCCP Act on 1 July 2013.

Both reports <u>fall seriously short</u> of this criteria.

The Delegation considers that it is very important for the Expert Panel and the Assistant Treasurer to be aware that there are many significant deficiencies associated with these reports and they should be considered as having very limited contemporary credibility.

Support for this comment follows.

"Caught Short"

The Delegation was particularly concerned to read that this obsolete report, with its very poor methodology, was considered by those developing the Consultation Paper.

It would be most unfortunate if any discussion in the Expert Panel's final report relied on this study, with data collection that commenced in 2009 and concluded early 2011 well before the commencement of the SACC regime, and then presumed that it reflected anything more than observations concerning several non-random samples, from several different categories of population, without any national contemporary perspective.

The Delegation's concerns include:

- the failure to effectively segregate the differentiated samples;
- the small numbers in each sample;
- the eventual small total number of 112 people, including small loan consumers, as well as others who had not taken out a loan, in what should have been the relevant time frame;
- the 3 states, rather than national selection;
- the mix of regional and big city suburban respondents, recruited from potentially variously biased sources, in uneven numbers determined by convenience;
- the inherent bias introduced by not employing any self completion questionnaire in the data collection process;
- the mix of face to face and telephone interviews, to produce generalised results;
- the mix of generalised questioning and encouragement for respondents to "tell stories";
- the substantial use of material from an earlier attempt to study consumers, which also had significant methodological issues; and
- the bias by location, employment and profession, with the non-random recruitment of 33 non-borrower stakeholders.

Given the above list amongst the methodological mix employed, the Delegation is of the view that this effort cannot be considered persuasive or valid, for any national assessment of any kind.

The effort must be regarded purely as a preliminary preparatory effort for what should have been a major disciplined study at a later date.

The Delegation, which did not exist at the time to assist, is sorry to note from the document that those involved were not provided with reliable, consistent and constructive assistance from the lenders. However, while the Delegation is confident that those involved were well meaning, the Delegation understands the industry segment's reluctance.

There has been a history of poorly conducted, alleged academic study of small amount/short term lending in Australia, much of it unwisely referred to in the Caught Short report, that has been fundamentally inept and of very limited assistance to fact-based, sound government policy development and decision making.

Notwithstanding that data was first collected in 2009 by another research group, for an entirely different project, then merged with data collected by distinctly different methods in 2010 and early 2011, with the report released in August 2012, consumer advocates and their allies continue to present the disparate results as applicable to a legislated lending model that did not entirely commence until 2013.

ASIC Report 426

The Delegation is concerned that many have incorrectly accepted this report as presenting contemporary, appropriately and professionally researched information, with fundamentally and accurately supported conclusions concerning the whole industry sector, relevant for national policy making and decisions to be imposed on all Australian Credit Licensed SACC providers.

To that end the Delegation is disturbed to note the number of times, since it was released in March this year (2015), that spokespersons for the consumer advocates have referred to the report content as if the research was contemporary.

This referral could indicate a failure to carefully read the report given that, on page 22, the report states "*The participants were …asked to provide details of the small amount loans they entered into during a two week period in August 2013*".

The details included copies of the contents of the consumer files, specified by type of loan contracts by ASIC. The behaviour commented on in the report occurred 25 months before the current SACC Review, in regulatory circumstances considerably different from those that are now applicable.

To read the report in this manner would overlook the substantial methodological weaknesses that deny the validity of such acceptance. The report cannot be taken as a measure of contemporary lender behaviour, because:

1. the data collection was limited to a 2 week period in August 2013, shortly after the commencement of the key SACC legislation, the meaning of which was still being clarified by Treasury in 2014, in revised relevant ASIC Regulatory Guides, and with amendments by ASIC Class Orders issued well after the data collection;
2. ASIC had originally involved 28 lenders, out of a total of 1,208 lenders licensed in December 2013 (at least 620 of which provided SACCs at the time), who provided ASIC with 34,000 loans from the fortnight reviewed;
3. however, only 13 lenders were eventually chosen, with all of them having come to the critical notice of ASIC previously via complaint from third parties. They were described in the report (paragraph 105) as "*at high risk of non-compliance*";
4. 4 of the lenders were responsible for 92% of the loans reviewed, and no other unbiased sampling of lenders was attempted;
5. a presumption that the lenders involved were "*responsible for more than 75% of pay day loans to consumers in Australia*" was accepted, even though it was only loosely based on a 2010 estimate, on a 2012 industry survey (Smiles Turner) and on information the targeted lenders provided (none of whom were known to have undertaken any research);
6. 288 consumer files were selected from a population of 16,561 files held by the targeted lenders;
7. this selection was far from random, with ASIC specifically requesting a selection based on prescribed criteria. One of these criteria - triggers for the presumptions of unsuitability due to 2 loans in 90 days, or a previous SACC in default at the time of the new loan assessment - was the focus of adverse assessment in the report, without any clarification that they did not represent the findings from a statistically relevant, randomly selected group of lenders and a randomly selected group of their consumer files;
8. the involvement of the targeted lenders was far from representative of the structure of the industry sector and failed to reflect the dominance, by number, of small business lenders participating in the industry sector;
9. frequent expressions such as "*some*", "*there were examples of*", "*we saw examples*", "*overall*", "*in many instances*", "*some payday lenders in the review*", and "*our review identified instances*", followed by critical comment, did not give any statistically relevant quantum; and

10. adverse comment concerning The Cash Store Federal Court case, determined in August 2014, one year after the data collection, and on the Teleloans and Fast Access Finance cases, which were still before the court at the time (one later being a crushing defeat for ASIC), was intermingled with comment on the 13 lenders' consumer files.

This report raised issues that were important as a matter of compliance for a number of the targeted lenders and, presumably, for some lenders not targeted during the data collection period. However, these had been, or may have been, significantly addressed throughout much of the industry sector by the time the report was released on 17 March 2015. The Delegation is aware of substantial and widespread relevant staff training, in regard to these topics, that was undertaken during 2014.

The fundamental failure to make any attempt to undertake a follow-up study of the targeted lenders, or the industry sector as a whole, to determine what relevance the issues raised in the report actually had at the time the report was finally released - 18 months after the data was collected and 6 months before the then scheduled SACC Review was to commence - is most unfortunate.

It is a matter of some concern that the methodological weakness and the obsolescence of this report has gone unnoticed by the ASIC media releases that refer to it, and the consequent media coverage that follows. It would be most unwise to attempt to base current comment concerning lender behaviour on the statistically questionable and inadequate, biased and potentially highly likely to be obsolete findings in this report.

Concerning both reports

With relevance to the legitimacy of both reports, the Delegation notes the post-implementation Review provision at Section 5 of The Australian Government's Best Practice Regulation Handbook, which indicates that reviews should commence "*within one to two years of the regulations being implemented... allowing a longer period will sometimes be more appropriate. For example, it is possible that even after two years, some benefits of the regulation or regulatory change may not yet be apparent*".

In other words, both the original and the amending legislation should actually have commenced before conducting the Caught Short data collections, if that report was to have any relevance to the SACC Review.

Further, ASIC should have recognised at least some time for the targeted lenders to adjust, beyond 6 months and 6 weeks respectfully. This would have ensured that both reports satisfied the Commonwealth Parliament approved, methodologically sound standards in regard to the timing of their review.

It would also have acknowledged what the, then, Minister for Financial Services and Superannuation, Bill Shorten, said when introducing the Amendments Bill in 2012:

"...*given the likely impact of these reforms, it is considered desirable to expressly amend the bill to introduce a requirement for a review of the operation of a cap after it has been in force for two years. This will enable consideration of the effect of the reforms and of matters such as the level of the cap and whether there is a need to address avoidance techniques that may be developed in response to caps...*".

Digital Finance Analytics

At the commencement of the SACC Review period, the Delegation was briefed on a research effort by the research company, Digital Finance Analytics, commissioned by the Consumer Action Law Centre, Good Shepherd Microfinance and the Financial Rights Legal Centre.

The Delegation suggests that, while Digital Finance Analytics are known to employ modelling and simulation and to undertake weekly surveys of households nationally, any report presented by this company or its clients should be critically reviewed, on the basis that:

(a) there has not been any consumer advocate-announced attempt to undertake any research associated with small amount/short term lending on a national basis, or even a 3 state basis, since the 2010 Caught Short data collection in 2010 - until the Digital Finance Analytic efforts surfaced;

(b) Until recent weeks with a survey that considers only some of the issues raised in report 426, and with results still to be published, ASIC has not made any attempt to undertake a follow up study to analyse either the continuing behaviour, or the altered behaviour, of lenders associated with the ASIC Report 426 - or to consider the behaviour of other lenders, which could have been a useful reference for Digital Finance Analytics;

(c) there has not been any reported contact with anyone of the 177 Australian Credit Licensees represented by the 2 peak industry representative bodies, or with any non-member who participated in the recent CoreData research program. These lenders constitute all but one of the major relevant lenders, all but 3 of the medium sized lenders and over 100 of the smaller lenders in Australia and provide in excess of 70% of all SACCs in Australia;

(d) there has not been any reported contact by this company with Smiles Turner, the only research firm to have conducted 27 major research programs involving the microlending industry sector, with response numbers far in excess of any other Australian research and who has also conducted 5 smaller programs, with samples generally as big as any past academic research focused on the small amount/short term lenders and their consumers, between 2002 and 2015;

(e) although admittedly less reliable and relying on informal communications, none of the 177 lending company supporters of the 2 peak industry bodies has reported staff, in any one of their over 230 shopfront lending outlets, being approached for information - or any consumer telling a staff member that they were participating in a research program conducted by Digital Financial Analytics.

The Delegation understands that Digital Finance Analytics was commissioned to undertake consumer analysis but was not asked to research the commercial lenders' ability to survive in business under the consumer advocates' preferred regimes of either 48% interest or a reversion to the 10%, 4% permitted fee model, or to research how the not-for-profit lending sector will cope if the consumer advocates are successful in abolishing commercial SACC lenders. Either regime would make lending SACCs totally uneconomical in the face of current costs, let alone the possible addition of a national database and ASIC Industry funding costs that could emerge in 2016.

In fairness to Digital Finance Analytics, its report undoubtedly reflects only what its clients included in their brief and had the budget to cover.

ASIC "Small Amount Credit Data Collection"

During August 2015 ASIC comprehensively distributed, around the industry sector, what should have been a most useful survey, presumably in preparation for this Review. This survey sought a range of very important information for the year 2014-15.

Unfortunately, the survey was compiled:

1. without effective communication with key loan management software service suppliers;
2. without any contact with the three industry sector representative bodies; or
3. without any known "road testing" of the survey before distribution.

This resulted in the majority of lenders known to the Delegation only being able to answer just 5 of the 18 questions, two of which being their company name. Only a statistically irrelevant number of lenders were able to answer any more than those 5 questions and that included a number of questions where there was more than one possible interpretation as to the nature of the answer required. A number of lenders known to the Delegation were frustrated that they could not provide answers to most of the questions and, therefore, did not respond at all.

There were a number of questions requiring notice for the credit providers to deliberately collect the data. These specifically related to rejected applications. Under the NCCP Act, lenders are not required to keep information concerning rejected applications, as only assessment reports for approved loans are required.

In addition, there is a provision in the Privacy Code that encourages the destruction of all information associated with a rejected application, within 30 days.

There were questions that required input generally not available on most lenders' loan management systems, these included questions regarding the average length of SACCs, when the presumptions concerning default and two other SACCs in the last 90 days were triggered and the numbers associated with contracts exceeding the original contracted term by 30 and 60 days.

It is significant to note that, in regard to the 4 major providers of loan management software systems to the over 200 SACC lenders who choose not to invest in developing their own system, 2 of the systems could not provide information to assist with a number of questions, one could do so if the client had purchased an “add on” package, and one possibly could provide all necessary information. The latter is estimated to have the smallest number of clients.

In fairness, ASIC instructed lenders not to worry about individual assessment of consumer files, if their system did not provide the answers and the invitation to participate was expressed as voluntary but, unfortunately, with the caveat "at this stage".

ASIC’s unique position provides an opportunity for the comprehensive collection of information in a manner not available to the industry representative bodies and their research firms.

This was an important initiative for ASIC and, given its responsibility for supervising compliance adherence, the Delegation always wants to encourage ASIC to attempt to understand the industry sector. However, the Delegation was most disappointed that the chance to collect significant data and present to the Expert Panel and Assistant Treasurer, was somewhat lost.

Although the results of this survey have yet to be published, the Delegation expects that ASIC will make substantial reference to this inadequate survey during the SACC Review process.

PART FIVE

RESPONSE TO CONSULTATION PAPER QUESTIONS

Question 1: competing objectives

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

Answer: This balance is highly complex.

Currently consumers have a massive opportunity for protection, but this is being threatened. This threat is due to the regulatory complexity and costs of being compliant, including the imposed price controls and their impact, seriously threatening industry viability and, as a result, consumer access to credit.

The Delegation members accept the need for consumer protection. However, the trappings of consumer protection listed below have decisively and unnecessarily placed the existing balance heavily weighted in favour of the consumer.

Comment:

The Delegation is unaware of any overseas jurisdiction that has more consumer protection, than that currently imposed on small amount/short term lenders in Australia. There simply does not appear to be anything more that can be added to the straight jacket, without an end result that leads to the abolition of the SACC lending sector. This in direct contradiction to Government stated policy for both lenders and small business.

The only expectation now required is actual even handedness in ASIC's compliance enforcement and consistency of expressed expectation.

Any consideration of introducing further initiatives by the Expert Panel must include consideration of the following “consumer protection trappings”, which currently distort a realistic assessment as to what “balance” means:

1. Ceasing to believe that lenders will continuously advance money to borrowers who can never afford to pay the loan back. This belief, commonly held by consumer advocates, has never been accurate or logical.
2. Recognising that the SACC industry sector is now one of the most regulated business sectors in Australia.
3. Recognising that the small amount/short term lending sector is the first Australian industry to face price caps since World War II.
4. Recognising that ASIC compliance enforcement has been highly subjective, patchy and has favoured large companies. This reflects the management quality, inadequate staff training and organisational trauma inflicted by 4 substantial Government-initiated shake ups in the last 6 years.
5. Recognising that ASIC has insufficient contemporary small amount/short term lending industry sector knowledge, has not made appropriate and meaningful attempts to consult with industry to learn more, has not undertaken any economic modelling and has not undertaken any consumer research.
6. Recognising that any perceived lack in the current “balance” could well be repaired with an improvement in ASIC’s compliance activities, delivering a more evenly applied and fairer compliance supervision. This would mean timely attention to and, in other cases, increased attention to the business models and lending behaviour of the listed companies, would-be listed companies and some high profile companies. This would also mean less subjectivity in the interpretation of legislative provisions on the part of individual ASIC officers. These issues are comprehensively detailed in the Delegation’s submission to the ASIC Capability Review.
7. Making a decision to abandon the current dominant culture that presumes a consumer does not have any ability to make informed decisions and should be treated as a 5 to 10 year old child.

8. Being prepared to abandon the current dominant culture that does not place any responsibility on the consumer to read comprehensive mandated contract and associated documents, while lenders are hounded by ASIC, EDR schemes and Legal Aid for the slightest alleged compliance imperfection associated with the same documents.
9. Being prepared to critically analyse the consumer advocate claims, so often using their dated and inappropriately "researched" information. This sham, aided by the continuing presentation of the treatment of one - rarely fully investigated - consumer, as being typical for the treatment of all consumers, by all lenders.
10. Accepting that more legislation and regulatory controls may not be the answer because, ultimately, it is the consumer that can say "no" and the adult consumer (it is mandatory that all borrowers be over 18) - with the right to vote, marry, seek employment and be regarded by criminal law as legally competent - signs a contract implying acceptance of personal responsibility.

    The "balance challenge" is contributed to by non-lender stakeholders denying that the consumer has any responsibility. This despite signing a contract, which is recognised under contract common law as legally binding on both contracting parties and recognised as binding on the lender under the NCCP Act, without any similar recognition for consumers. Unfortunately, it is considered non-binding by consumer advocates, the External Dispute Resolution schemes and the so called "credit repair" companies - and the many dishonest borrowers who effortlessly and effectively exploit this system.
11. Convincing the consumer to actually read their loan documentation before agreeing to and signing the credit contract and associated documents.
12. Recognising the incredible burden now placed on the lender to explain the contract by the NCCP Act, ASIC Regulatory Guide 209, the decision in The Cash Store and Fast Access Finance cases, and the Channic trial.
13. Accepting that the Parliament has imposed a price control regime, in a manner that makes the already irrelevant concept of comparison rates even more irrelevant, as an element for consideration when adjusting legislation.

    Apart from the debate as to which formula to use, the fact that SACCs are priced with permitted fees calculated in simple interest terms, which all consumers understand, and the fact that most consumers have no idea what a comparison rate means, comparison rates can be manipulated extensively according to how frequently you pay off the debt and how long the term is, makes them irrelevant. This manipulation can produce results that can vary as much as double the lower figure, yet for the same amount borrowed.

Question 2: complexity

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

<u>Answer</u>: Yes. There are elements within the current regime that are simply highly inefficient or unnecessarily oppressive to the lenders.

A regime that encourages unnecessary expenditure by the lenders and imposes unnecessary inconvenience, is an indiscriminate penalty regime which leads to frustration and disrespect. Frustration and disrespect are not good foundations on which to build universal compliance which - given that resources allocated to ASIC for their policing role will never be enough to supervise every lender, every business day - must be fundamentally a voluntary one.

A higher level of consumer protection will be present throughout the lender sector if the culture is fundamentally voluntary, rather than resentful oppression.

Supporting comment and examples requiring change include:

1. Undertaking a complete edit and restructure of the National Consumer Credit Protection Act and associated Regulations, to address:

   (a) the cut and paste approach and mismatch of continued former state legislation, with attempted, no longer contemporary, inclusions;

   (b) clarifying the nonsense of a separate Pre-contractual Statement being a separate document to the final contract signed by the parties, or somehow different to the front pages of the credit contract, and just accept a complete merger of the concepts without any further reference to a Pre-contractual Statement;

   (c) elimination of the never read “Information Statement”;

   (d) encouraging the merging of the Direct Debit Request and the Direct Debit Agreement, so the two become one document;

   (e) consolidation of the provisions in the NCCP Act (including National Credit Code) and associated Regulations, to eliminate the scattered inclusion of definitions and compile them in just one part of the document;

   (f) more effectively group the various provisions into easily referred to and logically “complete” divisions;

   (g) elimination of the fabricated bureaucratic jargon, which replaced terminology accepted for centuries and used everywhere else today, including by ASIC officers and in the courts.

   Note the Delegation’s use of “lender” - one word used for centuries by all - in preference to “credit provider”, two words which are never used by consumers and rarely by the courts, in comparison to “lender”. Further, the use of “broker” - another word used for centuries - in preference to “authorised credit representative” - three words that completely confuse consumers.

2. Encourage consumers to actually read what the lenders are mandated to provide, to reduce the current unrealistically high expectation of complete and comprehensive explanation of every document by the lender.

   This in current circumstances where, if the consumer forgets that they have had the opportunity to read their documents, or alleges that they were not explained adequately by the lender, if at all, (frequently used as their reason not to repay), then the lender is assumed at complete fault and only video and audio taped evidence to the contrary could possibly suffice to assist the lender prove otherwise.

3. Establishing a meaningful and non-token dialogue between ASIC and the lenders. The era of imposing Regulatory Guides on lenders that are purported to be indications of ASIC’s interpretation of legislation and regulation, but are actually the equivalent of new regulation - without industry consultation - has got to end. As has the era of highly inflammatory media releases, generally with exaggeration and incorrect content that infuriates lenders, builds resentful disrespect and does nothing to contribute to consumer protection.

Clumsy attempts at inducing fear ultimately do not work, as any opportunity for co-operation is replaced with a resentful “us and them” mentality amongst lenders and their compliance advisers.

An ASIC/industry working party concept has been mentioned as part of the move to industry funding of ASIC next year. Such a working party does not need to have its meeting agendas limited to ASIC costs, fees for services and levy amounts. The working party concept also allows individual lenders, and not just their industry representative entity personnel, to have an opportunity for a non-adversarial conversation with ASIC officers.

The Delegation has included detailed comment about this issue in its submission to the ASIC Industry Funding Consultation.

Question 3: sanctions

Dot point one - is the current sanctions regime working?

Answer: Yes.

Comment:

Lenders are generally aware that there are draconian penalties for offences. Any failures in lender behaviour have little or nothing to do with the sanctions, but everything to do with ASIC's capability.

However, this question begs the real issue - are the current penalties appropriate?

The answer to that question is "No" -

1. Even a leading consumer advocate associated with Queensland Legal Aid has been critical of the opportunity for criminal penalties to be included in the regime. These were described by the Legal Aid spokesperson as "*draconian*" and, for once, there was lender agreement with Legal Aid comment.

2. The range of offences included for severe penalty is oppressive and draconian, and is often more severe than the penalties imposed by Australian criminal codes for offences the community would generally consider more heinous.

   The sheer number of opportunities to impose these severe penalties must be reduced. This is almost an issue for human rights lawyers.

   There are two relevant Acts that cover this area:

   - Part 2, Division 2 of the ASIC Act - particularly in regard to Sections 12BB (misleading representations), 12CB (unconscionable conduct), 12DA (misleading and deceptive conduct), and 12DB (false and misleading representations) provide ASIC with a very broad scope of power over Australian Credit Licensees - all attract penalties in the ASIC Act's most severe penalties range. Penalties include injunctions, adverse publicity orders, compensation to consumers, fines of up to $340,000 for individuals and up to $1.7 million for companies.

   - The National Consumer Protection Act includes very substantial opportunities for ASIC to exercise administrative power and impose penalties (fines, temporary cancellation or termination of licenses, substantial enforceable undertakings, orders to repay consumers), or to undertake prosecution.

     In the NCCP Act, there are 126 criminal offences that do not have a gaol sentence as an option (72 of which attract strict liability), but have fines ranging from $510 to $17,000. However, there are 70 criminal offences that <u>do have the option of gaol sentences</u>, with fines from $170 through to $340,000 and gaol sentences from 3 months to 5 years (with 7 of these strict liability). There are also 114 civil offences each attracting a maximum fine of $340,000.

     In addition, there are 34 overlapping offences, where the court can impose a penalty calculated as the total interest or permitted fees collected (up to $500,000) and, in these cases, the court can expand the coverage to include all consumers associated with a class of contracts. Further, for any offence, a court can order restitution or compensation for consumers, injunctions and adverse publicity orders.

     Courts are also empowered to declare a contract void, in whole or part, with consumers being refunded, plus paid compensation for loss or damage. Courts can declare conduct unfair or dishonest, with the standard of proof being "more likely" (than not), with the opportunity for refunds, plus compensation for loss or damage.

3. In addition to the offences and penalties, a consideration of sanctions must embrace a consideration of the processes leading to their imposition.

   In essence, sanctions are enhanced if the opportunity to have them imposed embraces an investigation methodology such as is currently provided with the examination provision in the NCCP Act.

Unlike a common criminal suspect, the lender has no right to remain silent, there is basically no associated opportunity to claim legal privilege concerning documents discussed, and a transcript of the examination is provided to the court without any opportunity, during the recording of the examination, for the application of the rules of evidence.

That means, unlike the evidence before the court in all other trials, the examination transcript is submitted "unprotected". If the matter ever came before the High Court, the court would have a field day.

4. In addition to the offences and penalties, there are provisions in the NCCP Act that effectively deny any opportunity for legal privilege over any document. To challenge the ASIC demand for the documents of concern is hard enough but, if there is a dispute, ASIC has the last word - it decides whether or not it will grant legal privilege status.

   Apart from the gross conflict of interest involved, there is the issue of ASIC having an opportunity to look at all the detail in the document before it makes its decision, even if that decision was miraculously in favour of the lender.

   This power compromises and distorts ASIC investigations and is blatantly in conflict with the rule of law.

5. Any consideration of sanctions must also embrace a consideration of the Federal Court Rules.

   The court processes are almost constipated with rule after rule that makes going to court for a lender a very expensive affair, even before the trial begins. With its superior resources and a policy of allocating at least four ASIC solicitors to each case to assist senior counsel, as well as a junior, ASIC can play the game of exploiting every rule. That means costly delay and, very significantly, ASIC's elimination of vital evidence for the defence at every opportunity. The potency of sanction becomes more significant in such circumstances.

6. Any consideration of sanction must also recognise that the Federal Court has a well deserved reputation amongst the Bar for generally being pro-government in its decisions. The decision in the Teleloans' case being a very brave exception.

Q. 3 - Dot point two - could the current sanctions be enhanced to make it more effective?

Answer: As indicated above, they are already draconian. In addition, what is the definition of "*more effective*" that the Consultation Paper seeks to present with this question?

Comment:

As the last 40 years of jurisprudence has indicated, penalty is not the significant deterrent, it is the fear of getting caught.

At present it would be fair to say that this fear is far greater amongst Australian owned, family financed and operated small lenders, than the high profile large, listed and/or overseas owned and/or funded, lenders that supply 70% of the SACC loans in Australia.

Question 4: obligations to obtain and consider bank statements (TOR 1.1)

Dot point one - is the requirement to consider bank statements necessary?

Answer: Yes

Comment:

The reference to lenders not accessing bank statements, in ASIC Report 426, is now nonsense. In the last 2 years, only one small lender, Money Plus, has been penalised for not obtaining bank statements.

The collection of bank statements is virtually universal for lenders, because it remains the best way of obtaining information to assist in deciding whether or not the lender will ever be repaid. As PAID International, The Cash Store and AMX all discovered and Nimble is now discovering, if you do not approach assessment diligently and comprehensively, including very careful reviews of bank statements, a lender loses money and can end up insolvent or never making a profit.

Attention to whether or not lenders are considering conflicting information revealed by the bank statements and whether or not they are ensuring that they get statements for all relevant accounts, are almost standard subjects included in lender staff training and are certainly key issues considered by compliance reviewers.

Since ASIC Report 426, major attention has been focused on these issues, they have been introduced to contemporary ASIC Regulatory Guides and it is unfortunate that no follow up research was undertaken before the writing of the Consultation Paper.

In addition, the consumer resistance to providing 90 days of bank statements, which lenders experienced after the legislation commenced in 2013, has now all but evaporated.

The circumstances reported on in Report 426 - which happened 2 years ago - are completely different to contemporary circumstances.

Q. 4 - Dot point one, dash - are there more effective ways to obtain information?

Answer: No.

Comment:

1. Any opportunity for more intrusive acquisition of consumer information is denied by the Commonwealth Privacy Act and Privacy Code.

2. The Review is about loans for under $2,000, with terms from 18 days to 1 year (note, the term is not 16 days, because there is more than one provision in the legislation impacting on the number of minimum days).

   With gross income limited to the permitted establishment fee of 20% and permitted monthly fees of 4%, there is not the profitability available to impose assessment periods that extend over weeks, in order to virtually trail consumers to observe their spending habits, or to make numerous enquiries of their sources of supply of goods and services over days.

3. Consumers also tend not to keep every expenditure receipt, even if they are issued by the supplier - just in the off chance they might need them to apply for a SACC sometime in the future. In fact, unless they are for a tax deductible item, consumers rarely keep receipts and commonly do not even keep their credit contracts (Smiles Turner industry research 2015).

Q. 4 - Dot point two - is it appropriate for lenders to use bank statements for marketing purposes?

Answer: In accordance with the Privacy Act and Privacy Code - not without the consumer's permission.

Comment:

1. Any recommendation by the Expert Panel would require amendment to the Privacy Act and liaison with the Attorney General, as opposed the Assistant Treasurer, which may be outside the Terms of Reference for the SACC Review. This also following major reforms to Australia's privacy regime being introduced only last year.

2. The Delegation is not aware of any lenders using bank statements for marketing purposes. Information included on the application forms used is much more applicable.

3. Use for marketing purposes demands permission via the Privacy Consent Agreement that must be signed by every borrower, in accordance with the Privacy Act.

Question 5: restrictions on repeat borrowing (TOR 1.2)

Dot point one - how do lenders determine the existence of other SACCs and defaults?

Answer: Bank statement review, supplemented by questioning the applicant borrower and requests to see any other loan contract documentation.

Comment:

Concerns about lenders inappropriately rebutting the presumption of the existing SACC in default are largely ill-founded. To all lenders, the existence of default, without exceptional explanation, is a red flag indicating potential unsuitability to proceed with another SACC.

CoreData research in 2015 and examination of approximately 650 consumer files by the Delegation Co-ordinators, in their role as compliance reviewers over the last two years, support the view that less than 6% of lenders have approved SACC loans to consumers with an existing SACC default.

Note, this figure does not mean 6% of SACC applications - it means that, subject to satisfactory explanation, from time to time 6% of the companies may approve a SACC in such circumstances.

The other 94% of lenders surveyed automatically did not lend in such circumstances, as a matter of company policy, no matter what explanation was proffered by the relevant consumer.

In the past, those lenders who have ignored this warning with any consistency in all their assessments have paid, or are paying, a heavy price of inflated default and bad debt rates. The marketplace itself is imposing a severe penalty. The current cost and economic circumstances impose a very conservative approach on all lenders assessing any applicant with a SACC in default, even if their company policy recognises the opportunity to rebut the current presumption.

Q. 5 - Dot point two - is a restriction on repeat borrowing necessary to protect consumers?

Answer: No. Given that the fundamental test is affordability, the number of loans is an artificial measure.

Comment:

One loan of $2,000 may create more difficulty for a borrower than 5 loans of $100.

Q. 5 - Dot point three - is a rebuttable presumption or a bright-line test/outright ban or a limitation on the number of SACCs more effective?

Answer: No one would know. It has never been tested.

Comment: on the answers to dot points one, two and three.

1. Significantly, the ASIC SACC survey this year sought to discover the number of SACCs lent in circumstances where the presumptions could apply, but did not seek any detail as to why these presumptions were rebutted, or lender opinion as to whether or not a ban or a limitation - without a rebuttal option - could be effective.

2. Neither ASIC, nor consumer advocates, have tested consumers in regard to effectiveness.

3. The lenders have tested the effectiveness of the rebuttable presumption. If you fail to consider appropriate justification for rebutting and lend, you lose substantial sums in bad debts. PAID International and The Cash Store are examples of lender insolvency to consider in this regard.

   Indirectly, the lenders have tested the effectiveness of enforcing artificial presumptions. If it is not what the consumer wants and does not satisfy their requirements and objectives, they go to a competitor.

4. If the lender imposes a presumption in circumstances where the consumer wants a (say) third loan and can afford it, the lender has committed a major offence under the NCCP Act, thereby failing to recognise the consumer's requirements and objectives.

These questions must be followed by a supplementary question -

Is such a presumption or bright-line test appropriate? This allows a more useful reference to the consideration requested in the Consultation Paper.

Answer: No.

Comment:

A summary response to the elements listed for consideration in the Consultation Paper -

1. The degree of protection afforded to consumers, by introducing the bright-line test, will be largely illusory.
2. Extra complexity delivers negatives.
3. Cost is actually not an issue in the impact on assessment, but is in regard to the compliant lender implementing the bright-line test and losing consumers to competitors.
4. Flexibility is desirable, or you conflict with an assessment cornerstone provision.

Detail supporting this summary -

5. The opportunity for rebutting the presumptions was adopted by the Treasury Consumer and Industry Consultation Group meetings (Treasury Consultation Group), well attended by all the major stakeholders, in the extensive consultation process over the 2 years leading up to the 2013 relevant amendments to the NCCP Act. They were extensively debated during those meetings.
6. Without the opportunity to rebut the presumptions, inappropriate issues emerge which have to be addressed, or absurd results occur.

   For example:

   (a) Limiting SACCs when there have been 2 SACCs in the last 90 days. What if one or both have been repaid by the time of the application for the third SACC?

   (b) Limiting SACCs where there is a SACC in default at the time of the application for a second SACC. What if the default has nothing to do with the consumer's ability to pay, but was due to the other lender's administrative failure?

   (c) Failing to recognise family circumstances associated with other people paying the bills, or adult children providing modest board.

   (d) Where there is "salary sacrifice" or the like and free or subsidised accommodation, meals and transport are provided by an employer.

   (e) Overlooking the possibility that the consumer may have had a positive change in their income level, which is likely to continue throughout the intended loan term.
7. Without the opportunity to rebut presumptions, there will be encouragement for consumers to seek larger loans in order to avoid the presumption applying if there is a need for a later application. This forces consumers to borrow more than they really need and ahead of their total actual borrowing needs.
8. The real protection afforded to consumers is not the artificiality of ill defined numbers of loans, or whether one is in default. Specifically:

   (a) It is not the number of loans, but the total amount of debt that matters. In the Government price-fixed SACC situation the cost is constant, regardless of the number of loans. The ability to repay the debt is a matter of responsible lending assessment, not how many loans are involved.

   (b) Without consideration of actual debt amounts, and the assessment of capacity of the individual to repay according to their unique circumstances, artificial specification of some number of SACC loans, such as 2, is illogical.

   One loan of a relatively large amount could place the consumer in the same financially threatening situation as a string of small loans. Three loans, with sequential reduction in debt burden, may be far more manageable, even allowing a relatively larger debt burden for a short time while all 3 loans are on foot - than imposing a system where the consumer is forced to take out larger first and/or second loans, with larger debt burdens throughout the total loan period, just because they know that they will not be able to apply for another loan.

(c) The presumption concept, without the opportunity for rebuttal, introduces rigidity without adequate foundation and takes the spotlight off the fundamental suitability assessment liability for the lender. Far better that the Expert Panel recommend an amendment to the NCCP Act, so that the concept of "substantial hardship" is not left with the absurd criteria of whether or not the consumer will have to sell their principal place of residence to pay the loan. This provision:

i. relates to an extreme situation;

ii. does not have any relevance to SACCs;

iii. does not provide any effective policy guidelines to lenders;

iv. allows ASIC to be vague in its reference to the definition in its Regulatory Guide 209; and

v. demands the unsatisfactory situation where compliance advisers have got to guess as to the advice they give their clients.

(d) Prescribing a number of acceptable loans has had a most negative result - larger or high profile companies such as Cash Converters, Nimble, the former PAID International and The Cash Store, sought to "buy" market share by doing everything possible to get their customers committed to 2 loans, thus attempting to impose what they saw as the 2 loan cut off, in order to exclude other lenders from being able to lend to the same consumer.

(e) The effective degree of protection afforded to consumers is an honest overall assessment of their capability to fulfil their contracted financial responsibilities, without the imposition of financial hardship that results in their inability to pay for basic living costs such as rent, basic food, adequate clothing, medical expenses and public (state) school educational expenses for their school age dependants.

Anything else is an artificial attempt to create key performance indicators that please those dedicated to regulation for regulation's sake, rather than the adoption of regulation which adequately defines lender behaviour and consumer financial expectation.

(f) Artificiality in regulation inevitably creates unnecessary complexity. Complexity interferes with logical and realistic assessment. Complexity drives avoidance in ignorance or in retaliation. It is irrelevant to the cause of consumer protection whether the consumer has 2 or 10 SACCs. The relevance is only can they service the 2 or the 10 under a legislated realistic definition of "substantial hardship".

(g) The cost of consumer loan application assessment is generated by the legislated and business survival need for the lender to holistically assess affordability. The issues as to how many other SACCs and whether or not another SACC is in default, are all part of this whole picture - they are not pictures in themselves.

To impose a bright-line test, by imposing some definitive number of loans, will appease the consumer advocates, but will ignore the danger that the focus will be on ensuring the army boots are very polished, while ignoring whether or not the boots are suitable for wearing for marching long distances. As ASIC recognises in Regulatory Guide 209, consumer credit history can be important.

What justifies refusing a consumer a third small SACC, in a two only SACC prohibition regime, if that same consumer has demonstrated many times in the past that three loans meet his requirements and objectives, and are always repaid in accordance with the contract terms?

(h) Any attempt to impose a bright-line test must be preceded with definitive market research and industry loan analysis. When the "two SACCs in the last 90 days" was suggested in 2011-12, its proposers did not reveal any research identifying why it should be two, rather than three or four. It just meant the Minister at the time could claim "something is happening".

Subjectively assessing something to be "a good thing" and reacting "for appearances sake", is far from good Government policy making and encourages some stakeholders to be intellectually lazy and demand Government regulation by outcry, without paying attention to objective justification. The Delegation does not believe that the legally competent Turnbull Government would consider such an approach to law making as satisfactory.

(i) If a presumption has to be maintained for political reasons, the opportunity for rebuttal is essential, on avoidance and cost grounds.

9. With the imposition of a bright-line test, with prohibition and no opportunity for rebuttal, the following is highly likely to occur:

   (a) As indicated above, lenders will be encouraged to lend larger loans.

   (b) As indicated above, consumers will be encouraged to seek larger loans.

   (c) There will be substantial distortion in the market, as many additional lenders seek to sign up consumers with their (say) two loans, thereby denying competitors any access.

   (d) Genuine consumers, dealing with genuine lenders, will be disadvantaged.

   (e) Consumers' requirements and objectives will not be met. This contradicts a cornerstone of the SACC regulatory regime.

   (f) To reduce the flexibility for lenders to exercise a rebuttable presumption opportunity, is to impose rigidity for rigidity sake and will mean lenders will look for opportunities to take their lending out of SACCs and into MACCs, where no such presumptions exist.

   (g) Consumers will seek to take out two or more loans on the same day, with two or more different lenders, to ensure their obligations do not show up “on the radar”, because the (say) two credit report applications will not have been listed and nothing will appear on the bank statements until the next day.

   (h) to the extent that a bright-line prohibition might work, substantial numbers of rejected consumers will be easy targets for the bikie gangs, who will absolutely not have any concern for any bright-line prohibition included in their lending policies.

<u>General comment</u>:

It must not be overlooked that lending to a consumer who has had two SACCs in the last 90 days, even if both loans are still current, involves four other significant “filters” in the assessment process. Bank statements are carefully assessed, credit reports are reviewed, credit histories with the lender are considered and interviews take place with the consumer.

Previous payment performance is clearly presented on bank statements, with information on regularity of payment and reversals of direct debiting (bouncing of payments) easily observed. Further, the patterns of expenditure that indicate competence in money management are clearly depicted.

These “filters” may also be supplemented by the current potential lender contacting the previous lender/s, plus consideration of invoices and the like indicating accounts rendered - if any.

It must also be remembered that the current NCCP Act SACC regime was created on a foundation embracing a concern that consumers would borrow just enough to cover the identified requirements and objectives. Extensive discussion concerning this issue occurred at a critical Treasury Consultation Group meeting and was articulated during an industry representative meeting with the then Minister, in his electorate office.

Appropriately, it was considered undesirable to have a regime that encouraged people to enter into a debt that included money they did not need for an immediate, or near immediate, foreseen purpose.

That foundation encouraged a regime that recognised it was not the number of loans taken out at different times that was at issue, but the capacity to service those loans without financial hardship - whatever the number (note, the Delegation does not accept “substantial hardship” as the test, but accepts “financial hardship” as the relevant test).

Q. 5 - Dot point four - would recognising a prescriptive benchmark avoid the debt spiral?

Answer: No more than the current expected assessment process.

General comment:

1. The introduction of a mandated benchmark reflects the continuation of the 1930's thinking, that has been abandoned in wage setting and social policy since the last century. The human condition is not suited for, nor successfully governed by, sets of tight little boxes.
2. Any advocacy ignores the fact that the most irresponsible lending, the lending processes with the most negatives when considered as against the NCCP Act regime and its development over the last 6 years, have been those adopted by lenders wanting to fully automate their businesses and use benchmarks.
3. Benchmarks impose lowest common denominator rigidity. Impose a benchmark and lenders will simply work only to that benchmark, because they know ASIC compliance inspectors will have a certainty to easily consider, regardless as to how inappropriate it is in the individual consumer's circumstances. That means, because of their individual circumstances, consumers may be provided with a loan because it accords with the benchmark standard, when the provision of such actually encourages default and the consequent debt spiral.
4. The creation of a debt spiral is not just about the Government's and the lender's policies. Many consumers who find themselves in a debt spiral are simply totally irresponsible with their money management.

We invite the Expert Panel to visit a selection of lenders to learn of the many examples of very cunning consumers and their ability to deceive, as those consumers create their own personal debt spiral by both their spending behaviour and comfort with taking money they do not intend to repay. To date, consumer advocates find it impossible to believe that consumers will lie - but they do and often very successfully.

The October 2015 Veda Cyber Fraud Report, reported that three quarters of consumer credit application fraud involved people lying in their applications, particularly in regard to disclosing existing debt. Veda reported that fraud rose 13% in 2014-15, with failure to disclose debt accounting for 9%.

Further, it would be useful to talk to some of the charity free-meal suppliers, with their stories regarding parents who buy cigarettes, soft drinks and lollies at relatively expensive corner stores across the road, before coming over to the church hall for a charity meal because they say they cannot afford basic food for their family.

It is not only during the assessment process where consumers simply lie, but also with their manipulation of hardship applications, where they seek assistance again, as they breach the earlier agreed change to arrangements that are frequently generously offered by the lender and brokered by a financial counsellor representing the consumer. Benchmarks do not assist in these circumstances.

These are the consumers that frequently claim to have ended up in a debt trap and then go off to the so called "credit repair" companies, to seek assistance to blackmail the lender into removing true adverse credit file listings. This is a system which is meant to stop the creation of debt traps, by informing lenders about people who have a bad credit rating and associated bad credit histories.

A rigid lending assessment system, with the "perfect and appropriate" benchmark, will never address these human failings and never address the causes of the debt spiral.

Consumer credit management education, expectation of consumers having at least some personal responsibility for their credit actions, ASIC discouragement of lenders who lend to every applicant (as appeared to be the case with the former PAID International, with the former lending policies of Nimble), and the elimination of the so called "credit repair" companies' blackmail tactics, are a priority in comparison to a rigid benchmark regime to attempt to control debt spirals.

<u>Specific comment</u>:

A benchmark test introduces the following problems:

1. How do you avoid the problems in calculation associated with all the well known benchmarks? These include:

    (a) the assumption of average expenditure categories. People allocate different proportions of their income to different need or wants;

    (b) assessment for the individual or stereotypical family, introducing an inflexibility that does not recognise different family and household circumstances and varying contributions and contributors to household income and expenditure;

    (c) lead times between cost measurement and calculation, and then between calculation and announcement;

    (d) capital city differences can be recognised, but it is rare for regional or suburban differences to be recognised;

    (e) benchmarks such as the Henderson Poverty Index were developed for very different purposes. Will the purpose for the benchmark chosen be appropriate for assessing people who want to borrow money?

    Employment of benchmarks discourages effective and conscientious detailed assessment of the applicant potential borrower's circumstances. The opportunity to lend and the liability to fulfil the financial obligations associated with the loan, is reinforced by many of the provisions in the existing NCCP Act, including recognition of the individual's requirements and objectives. The NCCP Act regime is about the individual, not some "averaged" entity.

2. These concerns are supported by ASIC, as evidenced in ASIC Report 447 (paragraph 80) and 445 (paragraph 206) and in an ASIC media statement distributed in May 2015, concerning the Bank of Queensland using benchmarks, ASIC made it very clear they did not approve of benchmarks as a major assessment tool.

    All three comments supported the view that a benchmark could not replace individual assessment. As the November 2014 version of ASIC Regulatory Guide 209 confirmed (paragraphs 49 and 51), benchmarks "*are not replacements*" for individual assessment. The Delegation supports the continuation of this ASIC view.

3. The opportunity to add a margin raises further issues, including:

    (a) Does this opportunity presume the benchmark is deficient?

    (b) What cost research will be undertaken to justify this margin?

    (c) Does the margin presume that SACC borrowers are somehow different to the general population and on what research is this assessment based?

    (d) How is this presumed difference measured and what criteria will be chosen that is not recognised in the calculation of the benchmark, in order to calculate the margin?

    (e) If the criteria already recognised in the benchmark is going to be included in the calculation of the margin - how and why - and why not all of the criteria used for the benchmark?

Q. 5 - Dot point four, dash one - which benchmark should be chosen?

<u>Answer</u>: None of the existing measures.

<u>Comment</u>:

All current benchmarks have substantial calculation and criteria issues that make them inappropriate for SACC assessment. None were developed for a lending situation. A quick and convenient fix is not the answer.

If the Expert Panel were to recommend the use of a benchmark, then the Expert Panel should have one developed specific for purpose.

Please note that any such development will have to entail contact with numerous actual and potential consumers in every state and major centre, nationally. This has never been done before by ASIC and has never been achieved with the sparse, embarrassingly inadequate and methodologically fundamentally unsound consumer advocate and academic research in the past.

Q. 5 - Dot point four, dash two - how should a benchmark be used?

Answer: ASIC got it right in the November 2015 version of ASIC Regulatory Guide 209.

Benchmarks, whether imposed by amended regulation or voluntarily used by lenders, should only be used for comparative purposes, following most of the assessment.

This is to discover whether or not the information obtained during the assessment process is within broad community behaviour, or what might be expected in the consumer's case with reference to experience with similar consumers, or whether it is very different and requiring further consideration. This is a further verification or double check by the representative, as to whether or not the information was accurately provided by the consumer and/or accurately recorded in the assessment form - appropriately, not automatic acceptance or rejection of the application.

Q. 5 - Dot point four, dash three - what is the likely cost or savings for lenders to be required to use benchmarks?

Answer:

Concerning costs -

1. A possible loss of business for lenders who are conservative in their lending assessments and rigidly impose benchmarks.
2. An additional item to add to the application and assessment form, unless the Expert Panel is going to recommend that the introduction of a benchmark is going to replace some of the current assessment requirements.
3. More staff time to be involved with assessment.

Concerning savings -

Nil. A thorough assessment still has to be undertaken, involving all the other existing mandated and court suggested criteria, unless the Expert Panel recommends elimination of some from the process.

Further overall comment, precipitated by the introductory comment to Question 5:

1. Rebutting the presumptions can only now occur with sufficient evidence to justify the lender's decision.
2. The Caught Short Report assessment of 25% use of SACCs for refinancing, was unsound market research and is not relevant to the issue of rebuttable presumptions. At issue with the presumptions is primarily the possible limiting of the creation of the further aggregated debt, not how much is used to pay off existing debt.

   This repayment of existing debt is strongly discouraged by specific provision in the National Credit Code, which prohibits the charging of the permitted 20% establishment fee for any SACC being used, in part or all, for the repayment of an existing SACC. This provision was introduced two years after the collection of data for Report 426.
3. The initial draft of the Enhancements Bill was amended not only for refinancing to lower consumer repayments, but for other reasons such as those listed above. Refinancing is not the major issue.
4. As indicated in Part 2 of this submission, the results mentioned in ASIC Report 426 should be considered in the following context:
   (a) The legislation had started barely 6 weeks earlier.
   (b) There were a number of areas of the law that were in a state of flux. For example, in November 2013 Treasury was consulting the Government Actuary on how the

MACC formula was intended to work and, in July 2014, Treasury sought to clarify the wording in the Government Warning notices.

(c) The sample was dishonest and distorted, by ASIC asking for files with exactly those attributes listed in the Consultation Paper. The files obtained by ASIC were not random.

(d) The lenders involved had already come to the attention of ASIC - ASIC did not contact a random sample of lenders.

(e) The "results", based on the files of 288 loans, were and continue to be presented as common to all 16,000 loans, created over a 2 week period, associated with the subjectively selected lenders.

(f) Ever since, in misleading ASIC media releases, the "results" were and continue to be repeatedly presented or implied as common to the industry sector.

As indicated earlier in this submission, the Expert Panel and the Assistant Treasurer would be most unwise to give Report 426 much credence.

Question 6: ban on (very) short term credit contracts (TOR 1.3)

Dot point one - has the prohibition on (very) short term lending been effective?

Answer: Yes.

Comment:

1. None of the Delegation supporters lend these short term loans (under 18 days).
2. Anecdotal evidence reveals, over the last 18 months, there has not been any lending of this nature amongst lenders known to Delegation supporters.
3. Two of the past biggest offenders are no longer in business.

Q. 6 - Dot point two - has the prohibition led to unintended consequences?

Answer: No.

Responding to the Consultation Paper's introductory comments to these questions:

1. Very few lenders ever offered these loans.
2. As the commentary noted, single payment loans are not just associated with the prohibited short term loans. Like all SACCs, they deserve the same rigorous assessment process.
3. While most compliance advisers discourage their clients from adopting a single payment model as a common offering, it must be recognised that such an arrangement can absolutely and objectively meet a consumer's requirements and objectives. These circumstances including:

   (a) where a consumer is legitimately expecting a relatively large and certain one-off payment, which the consumer wants to use to pay off the loan "in one go", rather than repayments coming from regular income; and

   (b) where the consumer receives their income monthly and does not want to have to manage weekly repayment arrangements.

Question 7: Warnings (TOR 1.4)

Dot point one, first question - are the warning statements effective?

Answer: Generally No.

Comment:

1. The current compliance regime presents a contradiction. On the one hand, consumers are being encouraged not to bother reading their contracts, even if inclined to as discussed above, and on the other hand consumers are automatically presumed to be prepared to read the mandated warning signs.

2. Consumers, particularly those returning consumers, see little merit in the warnings.
3. Consumers want their borrowing needs satisfied immediately and from the lender they have selected prior to being confronted with the Government Warning.
4. Consumers barely glance at Government Warning notices prominently displayed in lenders' premises.

   Delegation supporters have never reported a case where the existence of the Government Warning has been the reason the consumer discontinued seeking a loan with them. CoreData research indicates that possibly 5% of website visitors leave the site after reading the Government Warning.
5. These concerns are not just the province of lenders and their representatives. One relatively senior ASIC officer actually has so little confidence in the effect of the Government Warning that she has demanded lenders remove the warning, or any reference to it, from a panel at the bottom of their Credit Guides, despite this inclusion being the lender's effort to supplement the Government Warnings prominently displayed at all entrances and on the counter (as is required by the Regulations).
6. Similarly, a former senior ASIC compliance officer, now an ASIC-endorsed compliance auditor in private practice, has so little faith in the Government Warning that, when a lender licensed to offer both SACCs and MACCs, but only advertising MACCs on their website, included the Government Warning - he demanded that it be removed from the website until SACCs were actually offered.
7. The Delegation is aware that some consumer advocates are seeking to have the consumer sign a copy of the Government Warning, to indicate that they have read it. In response to this preference, the Expert Panel should be aware that when, of their own volition, some Delegation members introduced this procedure, ASIC officers insisted that they discontinue the practice on the basis that it was "self serving".

Q. 7 - Dot point one, second question - could the statements be improved?

Answer: No.

Q. 7 - Dot point one, second question, first dash - consideration of the content of the warning

Answer: No change, provided the Government can guarantee the availability of the other options.

Comment:

1. The Delegation is concerned that the content of the Government Warning continues to cruelly raise consumer expectations of the automatic availability of an alternative.
2. If the guarantee of availability is not possible, amendment must be made to the content, or the Government might be accused of forcing the lender to aid and abet the presentation of false information that could attract the anti-misleading provision in the ASIC Act.

Q. 7 - Dot point one, second dash - is improvement in manner displayed possible?

Answer: No.

Comment:

1. With the mandated requirements having been addressed concerning display, Delegation members have not received any feedback from consumers, consumer advocates or financial counsellors, as to how the display might be improved.
2. There have not been any reports of consumers, consumer advocates, financial counsellors, or ASIC officers visiting Delegation member premises or websites, to research improvements in display.

3. In the last 12 months, none of the Delegation supporters have reported being contacted by ASIC demanding changes to their presentation of the Government Warning on their website.

Q. 7 - Dot point two - should there be a hyperlink to the MoneySmart website?

Answer: Not unless the issues in the “Comments” below can be addressed.

Comment:

Before such a policy is introduced:

1. the content of the MoneySmart website would have to be vigorously addressed by ASIC and amended to make it relevant for SACC potential consumers (preferably with input from a lender Stakeholder Panel and/or industry working party, as proposed in the ASIC Industry Funding Consultation Paper);
2. the indications of other alternatives being available would have to be guaranteed by the Government, or consumer expectations would be further cruelly raised; and
3. without the above, the Delegation is concerned that this would place lenders in jeopardy of prosecution for aiding and abetting an offence associated with the misleading statements provisions in the ASIC Act.

The MoneySmart website encourages visitors to the Payday Loan page to contact the ASIC Infoline on 1300 300 630.

However, a recent telephone call to that number by a prominent Delegation supporter’s manager, indicated that some substantial retraining of personnel might be in order. This was in regard to the issue of SACCs being regulated by the NCCP Act, with the ASIC representative insisting SACCs were outside the Act and then reinforcing that statement after talking to her "manager".

Question 8: the permitted 20% establishment and 4% monthly fees (TOR 1.5 and 1.6) **Do stakeholders think the cap(s) has (have) broadly met the objective of providing adequate protection to consumers and allowed lenders to continue to operate?**

Answer: Yes, up until this year.

Concerning consumer protection -

The majority of SACC lenders have applied the caps as was intended, thereby protecting consumers in the manner specified in the National Credit Code, considered in huge detail by the two Parliamentary Committee Inquiries, and by the numerous Treasury Consultation Group meetings conducted from 2010 through to 2012.

Concerning the SACC lenders -

Commencing this last 12 months, cost increases that were out of the lenders' control (detailed elsewhere in this submission and below), plus the continuing costs of compliance, have dangerously squeezed gross margins - leading to lender insolvencies (The Cash Store, AMX, PAID International), lender losses (Cash Converters) and lenders leaving the SACC market (Money 3 and the 20-odd small lenders).

Comment on consumer protection:

1. The Delegation is only aware of three companies, encouraged by two compliance advisers, who introduced SACC contract models that do not appear to accord with what the other companies in the SACC lending sector use. ASIC is attending, or has attended, to at least two of these companies.

   At least two of these three companies' practices are referred to in the Consultation Paper in the last paragraph on page 26, and the first two paragraphs on page 27. The only issue the Delegation has in regard to these references, is the inability of the Consultation Paper to report on a prompt consideration of these companies by ASIC before, or following, the issuing of Report 426, while the majority of compliant companies wait in frustration, because they have suffered a competitive disadvantage for at least two years.

2. That means, currently, consumers are receiving exactly what the Parliament approved and the Treasury Consultation Group meetings discussed in regard to permitted fees protection, from at least 500 other lenders.

   The results of ASIC's and other's attention should see the three companies join these 500+ other companies shortly. No recommendations from the Expert Panel are required in regard to the three companies or their lending models.

3. In assessing consumer hardship, the Expert Panel and the Assistant Treasurer are invited to consider the following:

   (a) The repayment issues associated with the current and future SACC regulatory regime must be divorced from the general deteriorating economic situation. Commercial lenders must not be forced to be the subsidy mechanism for those borrowers being hit by the declining economy.

   Apart from imposing a government and charity role on SACC lenders, such a role is not possible, given the deteriorating margins available to SACC lenders.

   (b) Any evidence presented by consumer advocates of consumer hardship in regard to the permitted fees, must be examined very closely. When closely examining consumer files in their role as compliance reviewers, the writers of this submission have been astounded at the type of absolute discretionary spending that consumers, who are having difficulty repaying their loans, will continue to undertake without any attempt at rationalisation or control.

   (c) Any evidence presented by consumer advocates regarding hardship involving particular consumers, should be carefully considered. A continuing history of cheating on lenders, misrepresenting the truth when applying for loans, and unsuccessful money management associated with the so called “victims” involved, to “support” consumer advocate claims, is common.

   (d) The success of the Maurice Blackburn class action against Cash Converters, involving NSW borrowers under the replaced NSW cap regime, has encouraged a string of “copy cat” attempts to emerge. This is not to imply any comment on the legitimacy of this particular class action, or another recently announced involving Queensland borrowers under the replaced Queensland cap regime - that must be a matter for the courts - but the impact of these two cases has been noted by Delegation supporters, with an increase in what they would consider to be bogus attempts to take advantage of the high profile attention.

   Despite very different lender/consumer circumstances, because the particular Cash Converters models were not adopted by the lenders as a whole and the disputed lending models were applied before the introduction of the SACC regime in 2013, the Delegation anticipates consumer advocates will communicate with the Expert Panel, ignoring this chronology.

   (e) Care should be exercised when making assessments of the current regime and its success in protecting consumers, to avoid assuming that all of the financial trouble allegedly faced by the consumer claiming difficulty paying off their loan, is due to the “profits” the lender is making.

This frequent phenomena is explained by reflecting on the “*Examples of SACC structures for a $500 loan*” included on page 27 of the Consultation Paper.

As listed, the 4 month contract generates $180 gross profit for the lender.

That means 73.52% of the total repayments are those associated with the principal of $500, which the consumer has enjoyed spending immediately after receiving the loan funds.

It also means, with equal average weekly repayments over approximately 17 weeks in the 4 month period, and calculated only with regard to principal, that it will take the lender at least 13 weeks to recover the principal. It is only on the 13th week and the last 4 weeks thereafter, that the lender receives their gross profit. This wait has an economic cost. The present day value of gross profit only starting to be received 13 weeks after the loan is advanced, is somewhat less than the dollar amount, as calculated by economists. Most lender critics would not tolerate waiting 13 weeks before they started to get paid for the work they are doing this week.

A more significant cost emerges as a result of the timing of a default in loan repayments. If consumers are going to have trouble repaying, it generally starts considerably earlier than the 13th week. This has a significant impact on the lenders' finances. On average, at least 60% of loans "start to go bad" before the middle of the contract term (Smiles Turner research 2015).

When one SACC “goes bad”, most lenders face an average situation of having to lend three to four similar SACC loans in order just to break even (Smiles Turner research 2015).

That is why profitability for SACC lenders is so sensitive to bad debts, and why the consumer advocate assumption - that all SACC lenders lend to anybody, regardless - is utter nonsense. That is why the few lending companies that have adopted this strategy have already gone into receivership, or have been unable to boast of any profit for the period during which they have put it in place.

Comment on SACC lender viability -

1. The 20%, 4% cap regime was established at the suggestion (only) of Cash Converters in 2010.

   This was in response to the first regime suggested by the then Minister of 10% and 2%, which was totally un-researched, totally economically unfeasible for lenders, did not receive any economic analysis or justification from the numerous consumer advocates giving evidence before the Parliamentary Joint Committee on Corporations and Financial Services, and was ultimately rejected by two Parliamentary Committees.

   As mentioned earlier, in this context it is important to note that neither the Minister's 2010 Explanatory Memorandum, nor the Regulatory Impact Statement, made any effort to examine lender costs and the impact of the permitted cap regime then being proposed.

2. The Delegation was the only entity representing any stakeholder that provided Treasury, the Minister and the two Parliamentary Committees with economic modelling that demonstrated the cost challenges associated with accepting this cap regime.

   The economic modelling demonstrated that the cap regime ultimately adopted was “very tight” when general business costs, the cost of wholesale funds and the bad debt costs inherent with any lending of unsecured, relatively small amounts, were considered. This modelling was considered at a Treasury/Minister meeting, where the decision to increase the permitted caps to 20% and 4% evolved.

   Given that the Senate Legislation Committee did not conduct public hearings, the Delegation's submission included considerable detail concerning cost and the economic modelling -

   See submission No. 40, at http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Completed_inquiries/2010-13/Consumer_Credit_Corporations_2011/submissions.

3. In a number of areas, the costs factored into the economic modelling presented by the Delegation in late 2010, are conservative compared to contemporary costs faced by the lenders. In particular, the Delegation invites the Expert Panel to note the following increases that would have to be factored into any similar economic modelling today:

   (a) Premises rents - up 28% in Adelaide, 30% or more in the other capital cities.

   (b) Advertising - including Google costs, which have faced an 80% increase in the last two years, to $27 per click.

(c) Total marketing costs - extremely varied, but one large lender reports a top of $225 to obtain a new consumer. Up from an average of under $80 for lenders in 2010.

(d) Credit searches - $5 for very high volume, to $17 for smaller lenders, up at least $5 for most smaller lenders.

(e) Higher consumer bad debt, partly due to consumers' illegitimate exploitation of the EDR and hardship regimes. Lenders report up to a 1.7 percentage point increase because of these two cost pressures.

(f) Significant increases in EDR fees. 10-22% increases, according to category of attention. The lender is charged this fee, even if the complaint turns out to be bogus.

4. Consumers' dishonest exploitation of the hardship application regime which, under the NCCP Act, requires the consumer and lender only to accept an arrangement that the consumer can reasonably satisfy - frequently leads to the consumer dishonouring this second agreement, just as they did the initial contracted agreement. This behaviour introduces a significant increase in the allocation of cost associated with management’s time.

   This while the consumer advocates and financial counsellors, acting for the defaulting consumer, automatically expect the lender to accommodate their suggested repayment regime, under threat of the matter being referred to EDR at the lender’s expense and often attempting to negotiate a second hardship arrangement after the first has failed.

5. “Credit repair” company services and non-lender stakeholder assessment that consumers do not have to repay their loans if they do not want to - regardless of their financial circumstances. Delegation supporters have reported spending $6,000 on EDR scheme fees, fighting these companies through the EDR process.

6. The necessary inclusion of expensive compliance advice, due to subjective and variable ASIC interpretations of the NCCP Act, which was not envisaged with the composition of the economic modelling in 2010. This advice is now generally charged out at $350 an hour and far more for major city law firm compliance advice.

7. The amortisation of compliance advice, substantial and expensive changes to compliance manuals and associated documents, significant and expensive changes to credit contract and associated template documentation, significant and expensive IT systems process and content modifications and management and staff training associated with the preparation for and commencement of the 2013 NCCP “Enhancements Act” amendments. In these circumstances, lenders can expect to spend $4,000 to $7,000 on compliance documentation. It takes a lot of $300 loans, for 6 weeks, to cover such an expense.

   This could not have been accurately anticipated in 2010, as the 2011-2012 period when most of the relevant consultation occurred concerning content and final drafts of the legislation, had still to come.

8. The amortisation of compliance advice, substantial and expensive changes to compliance manuals, documents provided to consumers and template documentation, some IT content modifications and management and staff training associated with the preparation for and commencement of the Privacy Act amendments and the introduction of the Privacy Code in 2014.

   There was no indication these changes would occur when the consultation process was in train in 2010.

9. The amortisation of compliance advice, changes to compliance manuals and management and staff training associated with changes to the AML/CTF Rules commencing in 2014.

   Again, there was no indication these changes would occur when the consultation process was in train in 2010.

10. Significantly, despite lender representatives pleading for this consideration during the 2010-12 consultation period, all these cost increases have had to be accommodated under a regime where there is no automatic CPI or similar increase factored into the permitted fee cap.

    As indicated above, the limited profitability possible in 2013, already under pressure from costs increases occurring since late 2010, almost evaporated across the SACC lending industry sector during 2014 and 2015, and has evaporated for those companies listed earlier in this submission that, in the 2 years since 2013, have gone into liquidation under the cost pressures associated with increased operating costs.

    It should not be forgotten by the Expert Panel or the Assistant Treasurer that the response to the lender representatives' pleas for built in cost recognition was to offer this statutory SACC Review. In the first instance, this review was included in the legislation to ensure the opportunity for adjustments to the permitted fees, in line with cost increases, to at least maintain lender margins.

11. The history of the three companies that collapsed highlights the survival challenges now facing commercial SACC lenders. The Expert Panel and the Assistant Treasurer are reminded that the Parliamentary Joint Committee on Corporations and Financial Services' "*Inquiry into the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill*", was conducted in late 2010, with an intense day of witness presentation and questioning that included all the leading consumer advocate and consumer legal centre leaders, plus various Legal Aid witnesses and leading financial counsellor witnesses, all of whom had presented extensive written submissions - reported early in 2011 and rejected the then proposed 10%, 4% model.

    This outcome was supported by the Economics Legislation Committee's Inquiry into the same legislation, over the same period.

Both Committees' reports strongly recommended a Ministerial review of the then draft legislation. They strongly supported the existence of a viable commercial lending sector. Neither report included consideration of a viable alternative, or commented on any one of the many consumer advocate witnesses or their extensive submissions offering an alleged viable alternative.

This review was conducted under intense lobbying from stakeholders and with comprehensive contact with Members of Parliament and Senators, by both consumer advocates and lenders, and which concluded with the inclusion of the 20%, 4% model.

The Delegation's economic modelling was carefully considered by both Treasury and the Minister and the results of the consumer and lender research, undertaken for the Delegation, were adopted by a number of other stakeholders without criticism as to methodology. This in circumstances where Treasury solidly criticised the research of a major international research company engaged by a major lender.

All the economic modelling and research results supported figures no less than the 20%, 4% permitted fee regime in late 2010. As indicated above, fundamental costs have all risen in the intervening 5 years and new and unexpected sources of costs have emerged.

<u>Comment - consumer advocates and the 48%</u>:

The Delegation has been amazed that a senior spokesperson for the Consumer Action Law Centre, one of the advisory group member organisations associated with a NAB "small loans pilot" in 2008-9, has recently commented in the media that he views the current situation with SACCs having a fee regime, rather than the 48% annual cost rate regime, as constituting preferential treatment to SACC lenders.

This spokesperson conveniently overlooked the fact that MACCs not only have the 48% annual cost rate, but also a legislated (permitted) fee of $400.

The second issue he overlooked is that his organisation was one of the following organisations that advised the NAB on the conduct of the small loans pilot program. The organisations were:

- Australian Financial Counselling and Credit Reform Association;

- Brotherhood of St Laurence;
- CHOICE;
- Consumer Action Law Centre;
- Consumer Affairs Victoria;
- Foresters Community Finance;
- Good Shepherd Youth and Family Service;
- Griffith University;
- NSW Office of Fair Trading;
- Queensland Department of Justice and Attorney-General; and
- RMIT University.

The spokesperson also ignored the comments included at page 14 of the report on the Small Loans Pilot, released by the NAB in March 2010. This report, entitled "*Do you really want to hurt me? Exploring the costs of fringe lending - a report on the NAB Small Loans Pilot*", included the following comments in regard to the 48%:

"*The pilot can, however, speak to some specific outcomes. For example, the modelling suggests that you cannot lend below an APR of 48% for a loan portfolio of less than $5 million and an average loan size of $2,900 or less for a loan term of one year.*

The modelling also suggests that for a reasonable sized loan portfolio of approximately 3,000 loans at an average loan size of $2,900 - an APR within the range of around 30% to 35% is required to generate a modest profit of 20 cents in the dollar. This requires a capital pool of around $8.8 million and may be considered an average lender in this space.

....The modelling shows the need to investigate further the provision of loans with less than an average size of $700. Even large lenders (with portfolios greater than $20 million) would struggle to deliver such loans under the 48% per annum cap. This would be further exacerbated if the lending period was shorter than a year."

Even the substantially subsidised pilot scheme in which the Consumer Action Law Centre was involved, learnt that a lender lost money attempting to lend (what are now called) SACCs - at 48%.

The Delegation notes that, at the time, the current spokesperson's predecessor and consumer advocate senior colleagues were most concerned that no one should face credit exclusion. There has obviously been a significant change of policy for the Consumer Action Law Centre, with current policies indicating that the Centre's preference is to effectively abolish SACCs. The Delegation is unaware of any consumer testing before this announcement. Success with this policy will require a change to both Government and Opposition credit and small business policy.

Q. 8 - Dash two, question one - should the temporary exemption under ASIC class Order 13/818 allowing the actual amount borrowed, net of fees, to be $2,000 for a SACC be permanently regulated?

<u>Answer</u>: Yes.

<u>Comment</u>:

1. Permanency was promised by Treasury and ASIC, presumably with Ministerial approval, when ASIC Class Order 13/818 was released on 28 June 2013.
2. The Delegation has not been informed of any adverse comment from the consumer advocates or consumers, since the Class Order was released.
3. Lenders have arranged their IT systems accordingly.
4. Lenders have trained management and staff accordingly.

5. Lenders are already in regulation overload, with the major credit reforms to deal with in 2010 (NCCP Act and associated Regulations), 2011 (more Regulations), 2013 (NCCP Enhancements Act and more Regulations), 2014 (Privacy Act amendments and introduction of Privacy Code, plus new AML/CTF Rules).

Some constancy would not be unreasonable.

Q. 8 - Dash two, question two - should the provision allowing direct debit fees in certain circumstances for SACC repayments be included in Regulation?

Answer: Yes.

Comment:

1. It is unfortunate that the Consultation Paper has not recognised the fact that the SACC lender cannot collect and keep these fees, or receive any commission or the like from the direct debit servicing company.
2. Given the inclusion on page 27 of the Consultation Paper commenting on ASIC noting "*some lenders utilising complex corporate structures to suggest it is not the credit provider charging the fee*", it is unfortunate that the Consultation Paper has not recognised the fact that the majority of lenders' consumers have a direct debit processing arrangement with another company. Another company that has nothing to do with the lender and the contractual relationship is purely between the consumer and the direct debit processing company. There are in fact 4 major direct debit processing companies servicing most of the lenders - all of which have no connection with any lender.
3. In regard to reported ASIC allegations of a "*complex corporate structure*" in the Consultation Paper, which has not previously come to the attention of the Delegation as an issue about which ASIC has ever attempted any action - the direct debit processing companies that share directors or shareholders with a lending company operate independently of the lender, have ordinary company structures, have and/or continue to offer their services to the general SACC lender market place, and fulfil all the Corporation Act requirements expected of companies.
4. As with the issue of the boundary between a SACC and a MACC, discussed in response to the question above:
   (a) Permanency was promised by Treasury and ASIC, presumably with Ministerial approval, when ASIC Class Order 13/818 was released.
   (b) The Delegation has not been informed of any adverse comment from the consumer advocates or consumers, since the Class Order was released.
   (c) Lenders have arranged their IT systems accordingly.
   (d) Lenders have trained management and staff accordingly.
   (e) Lenders are already in regulation overload, with the major credit reforms to deal with in 2010 (NCCP Act and associated Regulations), 2011 (more Regulations), 2013 (NCCP Enhancements Act and more Regulations), 2014 (Privacy Act amendments and introduction of Privacy Code, plus new AML/CTF Rules).

   Some constancy would not be unreasonable.

Question 9: Centrelink Beneficiaries protection (TOR 1.7)

Dot point one - is the 80% gross income protection for Centrelink recipients receiving at least 50% of their income from Centrelink working effectively.

Answer: Yes.

Comment:

This provision supports the rebuttable presumptions. However, the writer's review of 650 consumer files indicated that almost the same outcome would have been achieved from the assessment process without the protected earnings provision.

Q. 9 - Dot point two - are there any additional groups that could be included in a similar provision?

Answer: Yes - as matter of equal and consistent treatment, those receiving 50% or more of their income as a pension, from any Government Department, should be included.

No - in regard to others classified merely in terms of income amount.

Comment - other pensioners:

Before introducing such an opportunity, research into the availability of other pension schemes' opportunities to mirror the Centrelink Advance scheme would have to be considered.

Comment - non-pensioners:

1. There is not the absolute clarity of income amount for these people, in comparison to Government pensioners (however called). That makes identification for application of any similar rule more problematic.
2. It may be useful to note that the Delegation is unaware of any call for expanding the protected earnings concept since the introduction of the concept for Centrelink benefits recipients, until very recently.
3. The concept of protected earnings is also indirectly covered by the ASIC-championed and generally accepted concept of a "buffer" of discretionary income being available, after all expenses and the proposed loan repayments have been deducted.
4. It should not be overlooked that a protected earnings provision attracts most of the same criticisms that can be levied at benchmarks.

Question 10: National database for SACCs (TOR 2.1)

A definitive consideration of the concept of a national database can only be made after far more information about the possible database model, or models, is available.

Information topics requiring recognition and consideration are listed under "General Comments" below.

Q. 10 - Dot point one - is there sufficient information currently available for a SACC provider to meet their responsible lending obligations?

Answer: Yes.

Comment:

1. A database could end up a cumbersome expense-creating edifice that will always be deficient, because non-compliant lenders will avoid listings and there will be forgetfulness and human error on the part of other lenders.
2. Bank statements provide all the necessary information and that could be captured on a database without breaching the Privacy Act, except if a SACC has defaulted after a direct debit facility has been cancelled or, possibly, on the day of the second loan application. These exceptions are not enough to justify the cost of the database edifice, when there is a cheaper solution (see discussion below).

Q. 10 - Dot point two - if not, would a database or comprehensive credit reporting be the answer?

Answer: No.

Comment:

1. As suggested above, a large database edifice would have to be constructed that would always be deficient via deliberate avoidance, forgetfulness and human error.
2. Any lender cost impost on top of the ASIC Industry funding model next year, is highly likely to prompt a wholesale exit from offering SACCs. This would be at a time when the Government has little interest in adding to the budget deficit bottom line, or

inhibiting the essential funding of loan books for the not-for-profit sector lenders, if such commercial lender exit was to occur.

3. This will not provide real time notification of a direct debit default because, with a direct debit processing company involved - as is generally the case and will become increasingly so, as the big banks continue rolling out their new policy of denying payday lenders access to bank direct debit facilities - and the bank administration time involved, it can be up to 3 days before the lender learns of the default, in order to report it to the national database.

4. The Delegation expects a possible need for the Privacy Act to be amended, to accommodate the potentially necessary change to the registration of defaults under the 2014 amendments.

5. There will be little choice but to presume database accuracy, thereby guaranteeing freedom from liability for the borrower. Legislation will have to be amended to cover this issue.

6. Comprehensive credit reporting may be seriously overrated in this situation. It cannot be assumed that if a database is rejected and mandatory comprehensive credit reporting is to be the substitute, that the same information will be collected.

7. As the Consultation Paper noted, the banks are already not participating in comprehensive credit reporting. This is for good reason - the penalties for getting it wrong are draconian, plus there is the extra cost and it provides very little benefit, if at all, if there isn't holistic, all finance sector participation.

8. Fundamental problems with comprehensive credit reporting cannot be overlooked. These include:

   (a) The cost of lender participation. For Veda, for a small to medium lender, this is currently $60.50 for monthly access, $17.93 per credit file search and, per listing, $1.09 for a monthly debt recovery alert. It is acknowledged that Veda's competitors are cheaper, but Veda is the dominant credit reporting body for SACC lenders.

   (b) The complexity of dealing with comprehensive credit reporting is reflected in the numerous and demanding requirements detailed in the Privacy Code.

9. If attached to a credit reporting body, it will make subscription to that credit reporting body compulsory whereas, to date, it has been optional for all Australian Credit Licensees.

10. With more than credit reporting body in the marketplace, there is the potential of costly duplication of subscription, enquiry and lodgement fees to be covered by the lenders.

11. As indicated elsewhere in this submission, the adoption of a database, or mandated participation in comprehensive credit reporting - even of the banks allowed it (which is very unlikely) - means extra cost for a SACC in an environment where margins are being seriously squeezed. If lenders are expected to pay, the economic imperative for some lenders to ignore database or comprehensive credit reporting costs to survive, will be overwhelming.

12. The consultation process with industry from 2010 to 2012, did not envisage this potential additional regulatory and cost impost.

13. Extra cost generated by either alternative means that, unless they are prepared to recommend an increase in the 20%, 4% permitted fees regime to cover the lender paying, or that the taxpayers pay via the Commonwealth budget, the Expert Panel would have to recommend that this be paid by the consumer. The problem with that model is - who pays if the loan application is rejected?

14. Either proposition contradicts the COAG post-April 2012 and current Federal Government major policy objective of reducing the regulatory burden on small business.

15. Apart from a potentially quicker same day register of defaults on loans, or the listing of a loan in the extremely rare case where repayments are not made from any bank account, or the cancellation of the direct debit facility before default - bank statements give the lender all they need.

General comments:

Early ministerial interest prompted ASIC to release a relatively brief Consultation Paper on the topic of databases, in January 2013. Until now, the issue appeared to have lost all momentum.

The Delegation notes that a promised report detailing issues concerning a database, which was to be available in March 2013, was never published. That is unfortunate.

Given that the concept of a national database has once again emerged and in the absence of the promised report, the Delegation compiled a list of topics that the delegation believes should be considered, before an informed decision can be made concerning a database. While recognising that several of these have directly or indirectly been raised in the Consultation Paper, the list is reproduced in its entirety for completeness, to assist the process of informed review and decision making.

Issues include:

1. Who will run the database?
2. Will all the information go overseas, as one of the companies vying for the job is a US company (Veritec)?
3. If so, what are the repercussions for adherence to Australian privacy laws?
4. How will the Privacy Act requirement that the operator can only be a credit reporting body be covered?
5. What will be the technical functionality?
6. Will it share a national single entry portal?
7. Will there by integration of lender software systems re. enquiry points or stages?
8. How will it interface with credit reporting bodies other than the operator?
9. When will it commence?
10. Will there be any test period to iron out the bugs?
11. Will there be any learning period after commencement where, provided the lender has made a reasonable effort, they will not get penalised if they do something wrong?
12. What information will the lenders have to report?
13. What will be the timelines and the definitions for a default listing?
14. What will be the timelines for a SACC listing and de-listing?
15. What will constitute valid circumstances for a delisting?
16. Will it be an addition to, or a replacement for, some element/s in the mandatory enquires and verification process?
17. What changes to the industry's privacy documentation will be required?
18. How will Privacy issues associated with repayment history be observed?
19. When will the specific requirements for these changes be provided by the Government?
20. How long will the industry have to introduce these changes?
21. Will lenders face a “membership fee”, in the same way the EDR schemes impose costs on lenders?
22. What will it cost to register a loan?
23. What will it cost to de-register a loan when the loan is paid out?

24. How will the lenders pay the fees?
25. What will it cost to upgrade a lender's loan management software to cope, or how much are the external loan management system companies likely to charge to upgrade their systems?
26. Will lenders have to register with the system provider?
27. What happens in regard to correction, if the system supplier gets it wrong?
28. Will lenders be liable for the way the system operates or malfunctions, in the same way as they are liable for the actions of subcontractors/outsourced service providers under the NCCP Act?
29. What will be the size of the penalty if lenders do not register a loan?
30. What will be the size of the penalty if lenders fail to re-register a loan?
31. What will be the penalty if lenders ignore the current content of the register?
32. How will the penalty regime impact on lenders continuing to have an Australian Credit Licence?
33. How easy will it be to check the register before approving the loan?
34. How fast will it be to check the register before approving a loan?
35. What will it cost to check the register?
36. Will the database be live?
37. What information will be included on a database?

The Delegation notes that, while potential suppliers have met with peak industry bodies and a selection of non-lender stakeholders have very recently indicated their support for such a facility, no one has attempted a cost analysis and that means all stakeholders are totally uninformed as to what the cost implications would be if the Expert Panel recommends the introduction of a database.

The Delegation is concerned in regard to two specific deficiencies in the database concept:

1. it will reveal the existence of SACCs in a manner that will generally replicate the information already available on the bank statements examined by lenders; and
2. it will be limited only to SACCs when, what is of interest, is all indebtedness and loan and lease commitments. These are already obtained from bank statements.

Q. 10 - Dot point three, dash one - cost of a database

Answer: A number of potential suppliers attended an industry workshop on databases recently.

Although they could not be definitive, because they did not have final design details, they indicated that the costs of access would not be much different from the current costs of obtaining credit reports.

These costs are currently \$5 to \$17, depending on volume.

That means a serious cost impost in the current, near marginal circumstances for SACC lenders, unless the consumer pays directly, as with the current direct debit facilities.

Q. 10 - Dot point three, dash two - any privacy concerns?

Answer: Yes.

Comment:

1. The national database will attract all the privacy issues that are associated with credit reporting bodies and will require similar attention, to satisfy the Privacy Act and the Privacy Code.

2. Significantly, this could be expected to attract the expensive audit process that is now mandated under the Privacy Code for credit reporting bodies.
3. The Delegation is not aware of any advocate for a national database, giving any attention to these issues and to the costs that will be created.

Q. 10 - Dot point three, dash three - advantages/disadvantages of multiple databases operating in parallel

Answer: There are no advantages, except possibly price competition, but the most likely arrangement to emerge would be a cartel and that would negate that advantage.

All potential suppliers made it very clear at the industry seminar that multiple databases do not work.

The disadvantages are numerous:

1. The cost and administration involved for lenders, communicating multiple times to different databases, is a negative.
2. Like the credit reporting bodies, no potential supplier wants to share information. That means reporting cost duplication for the lenders.
3. The multi-database system is potentially cumbersome and works against the primary motive for a database - almost immediate notification to the industry as a whole of new and defaulting debtors.

There is a major question that is neither raised nor answered in the Consultation Paper -

Who pays for the development and initial implementation costs?

This remembering that the SACC lending sector cannot afford any additional substantial costs.

Q. 10 - Dot point three, dash four - would a database assist lenders to discharge their responsible lending duties?

Answer: No. It will only provide a marginal advantage over the much cheaper and much easier alternative (discussed below).

Comment:

1. Apart from the possible 24 hour window concerning registering or noting a SACC in default - No.
2. Otherwise, as indicated above, the lender already has access to sufficient information.
3. It must be acknowledged that the only reason databases are in contention is because a major US supplier lobbied Independent and high profile Senator Nick Xenophon in 2010. This was when the then ALP Government was having difficulty gaining enough cross bench support to govern at the time.

In response to this lobbying with the US supplier of database services in mind (Veritec), the then responsible Minister Bill Shorten promised to put the issue on the agenda for future discussion. Until this political deal, there was no interest in the concept. It is now the fashionable “big ticket” item, trendy for the day.

Q. 10 - Dot point three, dash five, question one - the effect of a comprehensive reporting regime?

Answer: For many years to come, if at all - very little.

Comment:

1. The effect of a comprehensive credit reporting regime, without all key players involved - like the banks - is not impressive.
2. The fact that few companies have taken up the offer that currently exists to go for comprehensive credit reporting, indicates that it is a very long road before such a system has effective and comprehensive commercial use.

3. The Delegation considers that it would be virtually politically impossible to make it mandatory to participate in comprehensive credit reporting. Such a recommendation from the Expert Panel would highly likely be a political embarrassment for the Assistant Treasurer. The large institutions involved can make it very difficult for any Government.
4. Overcoming the problems associated with the comprehensive reporting regime process, as discussed above.
5. Finding someone other than the lender to absorb the costs, because the lender is not in a position to do so, also as discussed above.

The Delegation is concerned that any proposal to attach the national database concept to one or more credit reporting body, or any proposal to make subscription a mandatory requirement, would have to overcome the following:

(a) Monthly submissions of performance data.

(b) The resultant reflection of events up to 6 weeks earlier.

(c) Publication after 90 days.

(d) Default positions below $200 not recorded.

(e) A cost environment oriented to big publicly owned companies, not small business.

The Delegation is unaware of any consumer advocate organisation that has investigated the cost of either the national database, or comprehensive credit reporting.

Q. 10 - Dot point 4, dash one - if a database was adopted - what information should be included on the database?

Answer:

Consistent with the Privacy Act, the Delegation recommends:

1. name and identification details of the consumer;
2. the consumer's residential address;
3. name of lender;
4. commencement date of loan;
5. contracted completion date of loan;
6. regular repayment amount;
7. repayment regularity expected (weekly, fortnightly, etc.);
8. maximum amount of credit;
9. balance owing, if any, on enquiry day;
10. whether in default of a SACC on enquiry day;
11. loan details where a loan is not repaid via a bank account;
12. date loan actually paid off;
13. if terminated, rather than paid off, balance outstanding at date of termination.

Q. 10 - Dot point four, dash two - who should manage the database?

Answer: The Delegation notes the presumption of the database concept being recommended by the Expert Panel. We do not have any such presumption.

1. Not overseas companies, reporting all information overseas - for privacy protection reasons.
2. Not local companies under contracts that allow exploitation of the lenders, with unilateral fee and level of service supplier decisions.

3. A Government agency, such as the now effective manager of the Commonwealth Personal Property Security Register, would be the most appropriate alternative.

Q. 10 - Dot point four, dash three - how should the database be funded?

Answer: Government or consumer.

Comment:

As indicated elsewhere in this submission, the lenders do not have the capacity to absorb this expense and/or the ASIC industry finding regime expenses, starting 1 July next year.

The Delegation considers that the proposed forthcoming ASIC fees and levies, to be imposed from 1 July 2016 on the industry sector, will constitute another serious cost impost if the lenders have to absorb them.

It is therefore important that they be excluded, in a manner similar to the current exclusion of Government charges from the permitted SACC fees:

(a) That the annual levy, imposed to pay for ASIC general services promoting consumer protection, be apportioned as a cost to borrowers, in accordance with a calculation based on the levy divided by the total number of loans in the preceding 12 months, or some other calculation that allows each consumer to make a contribution to total levy cost that is as equitable as possible.

(b) That any ASIC fee generated by particular consumer services, be paid for by that particular relevant consumer, at the ASIC rate.

In this context, there at least two flow-on effects that must be considered:

1. A reduction in credit reporting body subscriptions if the database was not connected to the particular credit reporting service; and
2. if costs are not fully recoverable, the encouragement for lenders to move the applicants from SACCs to MACCs.

Q. 10 - Dot point four, dash four - should reporting be mandatory or voluntary?

Answer: As the current comprehensive credit reporting regime option has demonstrated, it will not work or be taken up if it is not compulsory.

Q. 10 - Dot point four, dash five - should, and when, should SACC lenders check the database?

Answer: Logically, every time they are assessing a SACC application.

Q. 10 - Dot point four, dash six - should lenders be charged a fee and should it be included in the cap?

Answer: Ideally no fee. If charged, not included in the cap.

Comment:

1. As discussed elsewhere in this submission, given the marginal state of many SACC lenders, any fee cannot be included in the cap.
2. However, this does not assist the lender when the application is declined.
3. Given the increasing number of declines, this issue is very significant.

Another method of payment has to be explored that does not involve the struggling SACC lender, or the impact of not being able to pass on cost will distort the assessment process to favour approval just to recover the database fees, or have the approved consumer pay.

The Delegation considers that the concept of a levy on transactions, as supported by the policy of the UK Centre for Responsible Credit, would be appropriate.

Further, given the cost pressures faced by the lenders, that such levy be paid either by:

(a) the consumer, in the same way that they would pay for a government charge; or

(b) by inclusion in an increased permitted establishment fee, to cover any database levy imposed on the lenders;

(c) that the applicant consumer will pay for the inclusion of their contract details on the database;

(d) that the cost of accessing the database during an assessment, regardless of ultimate approval of the loan application or not, shall be recognised. This recognition by the successful applicant paying for that access and the cost of the access for applications where the loan is not granted, being a factor in considering the calculation of the percentage amount for the permitted establishment fee at each review.

Q. 10 - Dot point four, dash seven - who should be permitted to access and amend information on the database?

Answer: Only the relevant lender who originally placed the information for access and amendment and other Australian Credit Licensees for access.

Comment:

1. This provides another opportunity for the out of control, so called, “credit repair” companies to blackmail the lenders. This time to remove notifications of loans in default or another SACC.
2. This issue supports the licensing of and ASIC control over these “credit repair” companies.
3. Consumers must never have access - the opportunity to dishonestly tamper with correct information is too significant.

Q. 10 - Dot point four, dash eight - what mechanisms should be in place to ensure the database is accurate?

Answer: An ASIC accuracy review team.

After the Capability Review and with the introduction of ASIC Industry Funding next year, there should be ASIC capacity to adopt this responsibility, which is an appropriate responsibility for a regulatory compliance supervisor.

Q. 10 - Dot point four, dash nine - how should the database interact with the other responsible lending obligations?

Answer: There can be no formal or mandated interaction without the expensive IT software systems required. This including both internal facilitation and the facilitation required to connect the lender with the database, for real time service.

The database should be a stand alone compliance assessment tool, simply adding possible extra information to that obtained from the bank statements and encouraging further verification where necessary, and the operation of the presumptions, where appropriate to justify refusal of a loan application.

A better, much cheaper, quicker to commence and simpler approach

At the time, the motivating reason for considering a database was simply to identify the existence and number of SACC loans. However, there is a way of addressing the current deficiencies associated with the bank statement regime, which would answer this concern.

The requirement is to identify exactly what a SACC loan is. This is currently rather difficult when looking at a bank statement. However, it can very easily be remedied. A bank entry notation would provide the answer.

This notation could be facilitated via the direct debit system, with lenders providing an “ABA”. This meaning communication in accordance with the Australian Bankers Association (ABA), or a Centrix file format.

There are 18 characters in a lodgement reference field that could apply, with just 4 of them being used according to a predetermined universal industry sector code. The 4 characters could identify SACCs, MACCs, AOCCs and leases (even NILS and Step Up). This system could provide far more useful assessment material than just 'a SACC listing on another expensive system'.

The Delegation has been informed that this system, automatically applied when processing direct debit input, is capable of identifying the type of loan/credit, where the payment came from and where it will go.

The Delegation recognises that there are some deficiencies associated with this concept. These include:

1. It would not reveal payments made by cash or cheque. However, those are generally revealed on bank statements and would simply require a continuation of what is already the case - enquiry and verification from the consumer.

   The extent of this problem is far from substantial. In the 650 consumer files reviewed by the Delegation co-ordinators over the last two years, recognising that there might be a bias associated with them coming largely from small lenders and involving primarily - but not exclusively - SACCs, only two had evidence of payment other than by direct debit.

2. Default information would still have to be obtained from the bank statements. However, no one is suggesting that the database would replace the need to examine bank statements.

3. It would also not provide information on existing loan balances. There is a similar deficiency with bank statements. However, including such detail in a database - not envisaged by the Minister in 2013 - could be a major cost and Privacy Act issue.

The Delegation notes that this system could be introduced:

- without any pressure from the lenders to have the consumer pay anything for the continuing service;
- to support 100% compliance certainty in regard to identifying whether or not there are two or more SACCs in the last 90 days;
- without expensive set up costs that have to be paid by someone, unlike the costly database concept;
- without supervision of the database company/ies by ASIC;
- without the risk of another monopoly or oligopoly costing lenders or the consumers;
- without worry in regard to the true identity of the consumer;
- without any alternative reliance on a database, on a compulsory comprehensive credit reporting platform, when it will be years before such comprehensive credit reporting is adopted by the major financial institutions with their major political clout; and
- without a potential need for amendment to the Privacy Act and/or Privacy Code.

In short a simple, almost costless, system, capable of being introduced in weeks not many months or years.

Question 11: additional provisions for SACCs (TOR 2.2)

First question - an additional provision

Answer: There is one directly related to SACCs - the inclusion of bank accounts that reveal expenditure.

ASIC, and lenders generally, have accepted that the bank statements to be included in the 90 days provision should be those that relate to both income and receipts. However this is not mandated.

Under Section 117(1A)(b), NCCP Act, the mandated requirement is only applicable to bank accounts "*into which income payable to the consumer is credited*".

There is no prescription to include accounts indicating expenditure, despite being in an assessment environment where it is considered mandatory to review the applicant consumer's expenditure regime.

The Delegation invites the Expert Panel to recommend to the Minister an appropriate amendment.

Q. 11 - Dot point one, second question - are there any (other) additional provisions?

Answer: Yes. There are a number of amendments that would make a contribution to reducing the burden on the lender, without interfering with consumer protection. These are:

1. Rather than a search only to discover further unnecessary compliance burdens to impose on lenders, some attention to the elements of unnecessary compliance burden, inconsistency and conflict, would be constructive.

   There are a number of areas requiring attention in the legislation and regulations that would not have any apparent contemporary impact on consumer protection should they be changed, but that would make a useful contribution in reducing the current burden on lenders.

2. The inclusion of a provision encouraging consumer truthfulness when making an application for credit. At present, the most applicable legislation concerning consumer fraud is to be found in the State and Territories' Crimes Acts. Unfortunately, the overworked fraud detectives in the State and Territory jurisdictions do not encourage complaints on relatively small issues such as SACC applications. However, this allows repeat offenders to continue to defraud lenders.

3. The Delegation is most concerned with regard to ASIC's infringement notice regime. While the penalties listed in the body of the NCPA Act are draconian if imposed at their maximum, and totally inappropriate if a gaol sentence is envisaged of any length, there is at least court discretion.

   This is not the case with ASIC imposed penalties. Part 6-2 of the NCCP Regulations is prescriptive in this regard.

   ASIC has flexibility in regard to determining the appropriateness of issuing an infringement notice ("*reasonable grounds*" in Regulation 39), but Regulation 41 does not provide any such flexibility and demands a one-fifth of the prescribed maximum penalty that is in the body of the Act for individuals, and a draconian maximum penalty a court could impose under the Act for companies.

   Regulation 41(3) provides other examples of totally prescribed or fixed penalties, giving no opportunity for leniency for otherwise good behaviour or the relative insignificance of the offence, comparative fairness with what a court might do, or ASIC consideration of special circumstances associated with the relevant lender.

   There is no flexibility associated with setting these penalties.

   In the interests of equity and justice - there must be a change to the Regulations.

4. Clarification of what constitutes the 90 Day period. At present, the NCCP Act provides that the bank statements will be collected for "*at least the immediately preceding period of 90 days*" [Section 130(1A)]. In his opening address at the Channic trial, senior counsel for ASIC indicated that the defendant had breached the provision by including the day of the application as the 90th day. The matter was not pressed at any time during the remainder of the trial. However, there could be confusion associated with any future trial, because of the use of the word "*preceding*".

5. The insertion of clearer explanations in the legislation and regulations, to reduce interpretation uncertainty, in particular the "substantial hardship" definition relating home ownership, which is inappropriate for SACC loans, to be replaced with an appropriate "financial hardship" definition.

4\. An assessment as to what information, currently in ASIC Regulatory Guides, that should be in the legislation and regulations.

5. Adequately clarifying that, just because a consumer claims hardship, does not automatically mean that they are a suitable candidate to be allowed adjustment to their contractual obligations.

6. Licensing and controlling the so called “credit repair” companies, so that:

   (a) consumers are no longer provided with an opportunity to pay comparatively large fees, for a service that they can basically access free of charge through ASIC or the EDR schemes; and

   (b) consumers are no longer encouraged by claims they can effectively ignore all legal liability for the non-repayment of their loans, by the use of a series of "blackmail" demands imposed on lenders, that seriously distort the credit reporting regime and encourage consumer dishonesty.

7. Enforcing a regime so that, without exception, consumers have first to seek assistance through the Internal Dispute Resolution (IDR) process before accessing External Dispute Resolution (EDR), to avoid the creation of unnecessary cost and the inconvenience of having to deal with the EDR scheme and pay for their attention, when the matter may well have been resolved with direct contact between lender and consumer in the first instance.

8. IDR focus on forms, particularly Forms 11A and 12A, rather than emphasising EDR and encouraging cost for lenders, when a costless process is already mandated and should be clearly presented as to be used by the consumer first.

9. EDR scheme amendment, to return the concept to a free conciliation service, rather than a privately owned prosecutorial arm of ASIC.

10. Eliminating the current situation where EDR schemes operate as ASIC agents, reporting alleged “systemic issues” to ASIC. This also creates a "blackmail" situation for lenders and provides an investigatory and, indirectly, a judicial power to EDR schemes that is far beyond that of their original purview of mediating between an individual lender and an individual consumer.

11. A new calculation opportunity regime.

    The legislated opportunity supporting the current SACC Review is a one-off. Under the NCCP Act there is no further opportunity for a review.

    To address this issue and recognise that it is impractical and unrealistic to have a price fixing regime that does not have the opportunity for staggered periodic review, the Delegation requests that the opportunity for reviews be included in Regulation, in order to facilitate future considerations.

    There could be an opportunity to integrate this annual review approach with the proposed ASIC Industry Funding Model, which will include a Stakeholders' Panel and industry sector working parties.

    These will meet annually to consider ASIC costs and cost recovery, and the necessary fees and levies industry will pay the following year. As these fees and levies will contribute to SACC lender costs, their determination will be relevant to any review of SACC permitted fees and consistent timing of both reviews would be administratively efficient.

12. An increase in the total amount of the permitted fees.

    The Delegation’s assessment of current costs, in association with the previous economic modelling accepted by Treasury without criticism, indicates that a return to the net profit levels obtained from trading in 2013 would require a new permitted fee regime of 25% and 4%.

    The increase in the permitted establishment fee requested, reflects the fact that many of the additional costs are associated with the pre-assessment and assessment periods, rather than the on-going loan management period.

13. Removal of comparison rate provisions that are now obsolete.

14. Compensation (Section 47, NCCP Act) clarification to be consistent with a recent ASIC letter announcing that the recipient lender did not need to take out PI insurance.
15. The removal of "interest" terminology and requirements, when interest is prohibited for SACCs.
16. Electronic document delivery - clarity and consistency with other Commonwealth legislation, allowing all documents to be delivered electronically. This including electronic bank statement delivery, with or without the associated client report.
17. The cost of electronic bank statements, being $2 to $4, to be attributable to the applicant borrower and not included in the permitted fees.
18. Government Warning statement content comprehensively reviewed, to remove the opportunity for the warning to be misleading and deceptive to a casual reader.
19. NILS and Step Up loans to be brought under the NCCP Act and associated Regulations regime, to create a level playing field and to ensure consistent consumer protection.
20. Introducing the opportunity for lenders to take security on a SACC. This to address an anomaly when, currently, if you lend a MACC for $2,001 you can take security, but if you lend a SACC for $2,000 you cannot.

Q. 11 - Dot point one, third question - elements to consider from overseas jurisdictions

Answer: None.

Comment:

The Delegation has been unable to discover an overseas jurisdiction with as much regulatory imposition as exists in Australia - let alone more. Almost all differences that can be identified appear to be in direct conflict with provisions already existing in Australia.

However, the Delegation has identified the following regulatory concept employed in an overseas jurisdiction, where introduction in Australia would not involve major conflict with current provisions, or the need to introduce amending legislation that provided for fundamental repeals -

The introduction of a cooling off period of 24 hours (Florida, USA).

Question 12: anti-avoidance provision (TOR 2.2)

Dot point one - are stakeholders aware of any avoidance practices in relation to the Credit Act?

Answer: It is not the role of the Delegation to presume avoidance, without substantial investigation, and then publicise this presumption in a submission to a Government Review.

Comment:

1. This question is an improper request for untested gossip or suspicion, that could be most unfairly damaging to a lender that, in fact, was discovered to be compliant after appropriate professional investigation.
2. This question supplants the process of complaint already available with ASIC.
3. It is the Delegation's policy to report concerns to ASIC for (hopefully) thorough and objective investigation. This on the basis of a concern to establish a "level playing field" for all lenders, when it is carefully considered that there may be a lender exploiting non-compliance, while those lenders who adopt a compliant regime are disadvantaged in the marketplace.
4. Only at the conclusion of such a thorough investigation, with the accused lender having every opportunity to explain and correct incorrect impressions and assessments, should any public comment or discussion ensue. This would not be achieved by any listing in this submission.

5. The Delegation notes that the subject of anti-avoidance was raised in connection with a draft Bill in 2013. The issues were canvassed in an invited submission presented by the Delegation (see "*Submission Regarding Anti-avoidance (s323A National Credit Code)*", May 2013, at http://www.financeindustrydelegation.com.au/submin.html).

Q. 12 - Dot point two - should any additional anti-avoidance provisions be included in the Credit Act?

Answer: No.

The Terms of Reference (paragraph 4) for this SACC Review, including attention to fairness, efficiency, regulatory compliance costs and consumer protection, are against the adoption of additional "*anti-avoidance provisions*".

Comment:

1. In an ASIC environment where:
   (a) a traumatised ASIC is still getting over 4 major Government-initiated internal shake-ups in 6 years;
   (b) ASIC is desperately trying to avoid a fifth shake-up following the current ASIC Capability Review, and seeking any easy target activity to present the organisation as being effective and successfully doing its job;
   (c) there is a history of unequal treatment of lenders, according to whether or not they are ASX listed, funded or owned internationally, or family owned businesses;
   (d) there is a history of almost sham court prosecutions, that either involved litigation against atypical non-existent, insolvent, or soon to be insolvent companies who were never going to be able to pay the fines awarded or the court costs involved;
   (e) there is a history of totally unnecessary overspend on legal teams seeking high profile court decisions, without any attempt to negotiate an appropriately tough out of court settlement, or significant administrative penalty;
   (f) a schoolyard bully approach to compliance enforcement can, and does, involve powerful ASIC officers -
      i. simply "declaring" that they do not like a business model - to justify licensee cessation - while admitting the model involved did not breach any section of the NCCP Act;
      ii. angrily offering an inaccurate ASIC media release, as the only response to a polite request for information as to what sections of the NCCP Act a challenged licensee was breaching;
      iii. imposing a regime of three expensive audits over 3 months, without having received any complaints or undertaken any investigation as to compliance, using a "feeling of no confidence that the lenders were compliant" as justification;
      iv. demanding substantial deletions from contract and disclosure documentation, contrary to 10 years of requests from consumer advocates, and state and federal government consumer protection officers, demanding greater disclosure - simply on the basis of a personal preference for shorter contracts - and without any NCCP Act provision supporting the demand; and
      v. making highly subjective and totally un-researched assertions about consumer confusion or levels of understanding, to justify demands for lender change; and
   (g) ASIC officers treat Regulatory Guides as pseudo-regulation, despite ASIC's disclaimer at the front of every Guide to say they don't (and the ASIC solicitor in charge in the Channic trial confirming that the Guide does not have any legislative credibility).

   To consider giving more power to ASIC would be <u>most</u> unwise.

   ASIC is not effectively or properly managing the massive powers <u>it already has</u>.

2. Calls for additional anti-avoidance provisions are unfortunate when, prior to those calls, the invitation has not been made to submit carefully researched information as to whether or not there are any alleged offences that have been investigated by the complainant. This while discovering that there are actually no legislative or regulatory provisions to cover the lender situation that is regarded as unsatisfactory.

3. The Expert Panel could be wise to wait for the report on the ASIC Capability Review which, if the spirit of this review is not defeated by those who can turn it into a whitewash or non-event, could be very helpful in assessing the real ASIC environment - before endorsing new power for ASIC.

4. There is a challenge facing the Expert Panel and the Assistant Treasurer. "Anti-avoidance provisions" is generally double speak for punitive and subjective authoritarian power, that supplements prescribed powers associated with particular offences with very broadly stated powers that do not deliver certainty to lenders. Broadly stated powers available to ASIC are invitations for tyrannical behaviour.

   This was once proposed with the outrageous Schedule 6 of the National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012, Section 323A which was a civil libertarians worst nightmare.

   The standard of proof was lowered almost to zero, the presumption of "innocent until proven guilty" was turned on its head and ASIC was to be given the power to simply allow an ASIC officer to declare something was a "scheme" and, by implication, terribly illegal.

   Section 323A of the Bill provided for ASIC compliance officers to have unlimited power to decide, in their "opinion", that it was "*reasonable to conclude*" that any element in a Credit Licensee's lending model - regardless of that licensee's intention or knowledge, regardless of the relevance of the particular part of the extensive legislation by which that model was covered, and regardless of how small an element compared to other reasons for adopting the model - constitutes avoidance of the credit legislation.

   There were 12 "*matters to have regard to*", all being unacceptable and highly subjective. A 13th matter related to any future legislation and the 14th gave the ASIC officer unlimited and highly subjective powers, with the opportunity to consider "*any other relevant matter*". In other words, a totally free reign.

   After intense lobbying by the Delegation (only), this travesty of Australian fundamental legal rights was withdrawn from public view. However, its legacy lives on with the ASIC officer behaviour described in point 1 above.

Despite all the concerns expressed in ASIC media releases about non-compliance and avoidance, ASIC has only ever taken two companies to court on anti-avoidance issues. The companies were Teleloans and Fast Access Finance and the decision in the Teleloans' case was substantially against ASIC.

Question 13: documentation of suitability assessments (TOR 2.2)

Dot point one - how do SACC lenders currently meet suitability assessment requirements?

<u>Answer</u>: On the basis of the majority of the 650 consumer files examined over the last 2 years and referred to earlier, and ASIC's review of the consumer files of 6 Delegation supporters, from time to time - it appears SACC lenders do well, with generally appropriate attention to the NCCP Act specified requirements.

However, from time to time, ASIC has been right to be concerned about attention to inconsistencies. This a matter of management and staff training, not the need for new legislation or regulation.

It is noted that none of the inconsistencies that required further attention involved material non-compliance, or direct breaches of the regulatory requirements.

Q. 13 - Dot point two, question one - what is the most efficient and effective way to document suitability assessment?

Answer: As all lenders do - provide representatives with a template form or the equivalent on a computer software system, that addresses the major assessment compliance issues.

Q. 13 - Dot point two, question two - is it possible to use the same steps for actual and demonstrable compliance?

Answer: Yes.

Comment:

For administrative convenience, the same form or electronic equivalent should achieve the two purposes.

Q. 13 - Dot point three - should SACC providers be required to document the assessment?

Answer: They all do.

Comment:

ASIC demands that consumer files must demonstrate how the representative arrived at a "not unsuitable" assessment, without the need for an ASIC compliance officer or auditor/reviewer to ask questions of the lender's representative.

Further, the requirement to provide an assessment report, on consumer request (Section 132, NCCP Act), demands that assessment documents be completed and available.

Question 14: concerning Section 3, leases, the "equivalent" of SACCS (TOR 3)

None of the Delegation supporters are known to be offering leases of this kind and, accordingly, the Delegation does not provide comment.

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

None of the Delegation supporters are known to be offering leases of this kind and, accordingly, the Delegation does not provide comment.

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

None of the Delegation supporters are known to be offering leases of this kind and, accordingly, the Delegation does not provide comment.

Conclusion

We thank the Treasury Secretariat and the Assistant Treasurer for consideration of this submission and trust that it assists the SACC Review process.

As the second largest "peak" industry sector representative body representing SACC lenders in Australia with personnel who, for over 14 years, have had extensive experience liaising with representatives of Governments concerning the development of consumer protection and industry viable credit regulation, who understand the history of its evolution in Australia and who, prior to that, have been part of Government and understand the demands experienced from that perspective, we look forward to attendance at one of the series of Expert Panel meetings being conducted with stakeholders.

Finance Industry Delegation
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