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Foresters submission to the review of the small amount credit contract laws

Consultation on the regulation of small amount credit contracts and comparable consumer leases

Request for feedback and comments

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Review of the small amount credit contract law

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?

Foresters considers that the growth of the fringe lending sector is the symptom of a larger issue of many families and individuals having insufficient income to meet increased living costs. Within the current economic environment, SACC loans can sometimes become an easy financial strategy for those living on low incomes to get through periods of income or consumption shocks.

The Social Security safety net is only basic, and with unexpected expenses people are often under financial stress. The need for credit can be varied but often is the result of insufficient income support for some benefit groups, bad money management skills and people shuffling in and out of insecure or casual jobs.

Various regulatory measures may sought to protect customers but may create unintended consequences of entrenching financial exclusion, so ensuring continued access to credit for low income consumers is important. The small loan industry provides loan access, but it is important that the lenders do the right thing by the consumer in terms of responsible lending. The need to protect consumers should be around enforcing responsible lending with proper enquiry into the consumers situation so that the best and most appropriate solutions are always offered to consumers.

However, conflict of interest is inherent in running a profit producing business, and thus many businesses are not able to place social impact above the viability of their business. There is a need for ethical alternatives in the market which are able to meet the need for short term credit whilst providing options that are in the customers' best interests, and whose primary mission is community development.

Question 2: Complexity

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

The current regulatory regime is required as seen by the recent changes over the past few years. The reliance on "responsible lending" is expensive to enforce but enforcement efforts need to be continued as this is the primary issue faced by low income earners. Inappropriate loans just make their financial position worse and can lead to a debt spiral. The current regulations around SACCs is complex but a basic framework is much needed whilst lack of an active enforcement regime on responsible lending is not being fully actioned.

Question 3: Sanctions

The Credit Act imposes three types of sanctions -civil penalty breaches, criminal breaches and infringement notices.

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

Due to the number of cases where lenders have not practiced responsible lending, these sanctions should be increased in order to ensure customers are treated more fairly. Rather than focusing on sanctions, perhaps clearer ways to assess non-compliance may be useful, such as adopting a compulsory comprehensive credit reporting (CCR) regime. This would provide data and evidence to assist in the enforcement of responsible lending.

Foresters considers that sanctions and regulatory measures are unlikely to sustainably stamp out non-compliance/ avoidance practices as these practices may be inherent in the competitive survival of for-profit providers in the industry.

Foresters believes the best way to tackle exploitative lenders is the creation of alternative providers who act in the customers best interest. This will draw pressures on existing providers to also do the right thing by their customers. Increased resources should therefore be invested in creating an alternative non-profit market, especially for vulnerable consumers.

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

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

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

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

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

Foresters considers that the provision of 90 days bank statements is a necessary and effective measure to ensure broader responsible lending obligations. In our organisational experience, it provides information for both the customer and lender, as an education tool for building the customer's awareness regarding their own financial position and it enables the lender to conduct a proper assessment.

In some cases, bank account retrieval portals may be useful where this creates a barrier for access to credit, such as in the case of customers who are not computer literate or have disability issues. There are also privacy and security issues about using portal tools. Further there is value in the process of getting the customer to retrieve their own financial statement which builds financial capacity and understanding. The process of obtaining a loan on a marginal budget should require careful consideration, and business models which make this process overly "quick and easy" does not practice due diligence fully and in some cases is predatory and exploitative of vulnerable consumers. Suggestions for simpler and cheaper alternatives mostly benefit the lenders are generally not in the customers' long-term best interest.

Foresters considers it to be unethical to utilise customers' account statement information for the purposes of marketing. Any data mining of statement information should not be allowed to be used or sold on to third parties. As the customer is in a vulnerable position at the time of seeking credit marketing consents given as part of the process should be related to the product applied for and nothing else.

Question 5: Restrictions on repeat borrowing (TOR 1.2)

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

- How do SACC providers determine whether a prospective customer has a SACC with another SACC provider or is in default under another SACC?
- Is a restriction on repeat borrowing necessary to protect consumers?
- Is a rebuttable presumption or a bright-line test (e.g., an outright ban or a limitation on the number of SACCs that a consumer can take out in a certain period of time) more effective? When responding, please consider:
  - the degree of protection afforded to consumers;
  - the complexity for SACC providers who are making a decision to grant a loan;
  - the cost of complying with the requirement; and
  - the flexibility afforded to SACC providers and whether this flexibility is desirable.
- Would the objective of limiting a debt spiral through repeat borrowing be assisted by requiring SACC providers to rely on a recognised prescribed benchmark, such as the Household Expenditure Measure or Henderson Poverty Index (with or without an added margin)?
  - If so, do stakeholders have any views on which benchmark should be used?
  - How should a benchmark be used? For example, should the use of a benchmark replace the need to make inquiries about a consumer's expenses or the rebuttable presumption?
  - What is the likely cost or saving of requiring SACC providers to use benchmarks?

Foresters does not recommend any changes in this area, we agree with the current provisions as they exist. Foresters considers that a restriction to repeat borrowing (or a restriction for customer who is already in default) as necessary to protect customers. To ensure flexibility, the rebuttable presumption is preferred to a total ban but again responsible lending would ensure that any assessment decision can be supported by documented reasonable enquiry and a full budget supported by direct evidence.

The use of the 90 days bank statements can be used to discover any direct debits to other potential loan providers and dishonours are a clear indication that the person's budget is over stretched and they are potentially in financial stress. In these cases, further investigation is required to assess loan suitability.

Foresters does not support a benchmark approach as the only or final assessment process. Whilst a conservative benchmark and good credit score can be used to assist in a quicker and smoother process for some, many low income people need to be assessed on a case-to–case basis and taken through a budget and financial / life plan process to full understand their position, loan suitability and loan fit for their purpose. A benchmark process should not be used to replace reasonable enquiries – only support them and to ensure that any budgets are realistic.

As discussed above, obtaining a loan on a marginal budget should require careful consideration, and cost-effective screening methods are often depersonalising and mostly benefit the lender. Whilst benchmarks such as credit file, score or listings, traditional red flags and guide posts may be simpler and potentially save costs to providers, history has shown they have led to exclusion for many as shown by the small loan processes used by the main stream banking sector. As accessing a payday loan are often a last resort for many, these cost-effective screening processes may create the same financial exclusion perpetuated by mainstream banking.

It is important to note that whilst this provision is there to protect customers, it may have the unintended consequences of putting clients into hardship if their need for credit is not met. In order to practice responsible lending fully and ethically, appropriate support services and referral pathways must be presented as an option to a client, especially when they are declined a loan and/or presenting in financial stress. These support services may include referrals to emergency relief, food vouchers, financial and counselling services, legal advice, debt management, how to arrange payment arrangement instead of borrowing to pay a bill, how to budget and reduce expenditures.

It is difficult for private and for-profit lenders to provide this type service, and to have social objectives at the forefront of their business activities. This reinforces the need for building an ethical alternative in the community finance sector.

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

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

- Has the prohibition on short-term lending been effective in preventing lenders from offering loans with a term of 15 days or less?
- Has the prohibition on short-term lending had any unintended consequences that mean it should be changed? If so, please provide examples of these consequences.

We believe this has been effective and support the prohibition as low income earners generally need to budget repayments over a reasonable time frame. The use of short term contracts that force borrowers to either default, reschedule or refinance through other means just add to their costs and advantage providers via fee gouging.

Question 7: Warnings (TOR 1.4)

The Credit Act requires SACC providers to provide a specific warning statement to consumers.
Are the warning statements effective? Could the statements be improved? When responding, please consider:

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

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

Warning statements are a good idea but need to be incorporated into the actual loan application process. This is because physical signs are not always visible or located in a position that would facilitate the customer having the opportunity to clearly review the text, such as in a waiting area.

Warnings should not be seen as taking the place of making reasonable enquiries about the purpose and appropriateness of the loan to suit the customer requirements. Warning statements should therefore be integrated into the loan application process, such as the loan contract, and in a prominent position (not small print) such as on the first page of any loan contract offered.

On-line warning should have a hyperlink to the MoneySmart website, and the hyperlink should direct customers to the appropriate page (rather than the generic site) providing information on payday lenders, comparison rates and the availability of other providers and options. In order to be compliant, this hyperlink must not be broken and should be updated as appropriate.

Providers that offer cash loans for paying day to day bills such as utility accounts should be required to inform customers of other possible options such as making payment arrangements and Centrelink advances. They should be required to document and record this process has taken place.

Question 8: Caps on costs (TOR 1.5 & 1.6)

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

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

When providing a submission, please provide data, such as evidence that it is not viable for businesses to operate or evidence as to how the amount of the cap is causing financial hardship to consumers.

ASIC Class Order 13/818 granted temporary exemption from the cap for certain medium amount credit contracts (MACCs) and allowed small amount credit contracts (SACCs) providers to exclude fees charged for direct debit processing from the caps. Should the temporary exemptions provided by Class Order 13/818 be made into regulation?

Foresters considers the current provisions to be appropriate and generally does not have any changes to recommend as the broad objectives have been met, other than contracts with extended terms and split repayment amounts.

With contracts that extend the term with different repayment terms for the split periods this practice increases the number of monthly fees. One potential resolution is to mandate that the monthly fee be capped at the current 4% or 20% of the current monthly scheduled repayments which may reduce this practice.

We have no issue for the actual real cost of direct debit processing to be made into regulation as long as these are not inflated and are industry norms. All other fees should be retrained into the current caps.

Question 9: Protection for Centrelink customers (TOR 1.7)

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

- Is the protection for consumers who receive 50 per cent or more of their income under the *Social Security Act 1991* working effectively?
- Do any additional groups of consumers need to be subject to specific protection in relation to SACCs? For example, should the provisions be extended on a similar basis to persons whose income is less than a specified amount or recipients of payments under the *Veterans' Entitlements Act 1986*?

Foresters recommends this protection to be extended to anyone who possesses a Centrelink healthcare or pensioner card, as the incomes of those individuals are already assessed by Centrelink to be of a low income household. This may be an efficient and effective way to document suitability assessments though it may create market discrimination for loan access for those individuals.

As discussed previously, such caps may create unintended consequences for those who are most in need. The cap may reduce credit that a Centrelink customer be able to access and create hardship. This is why referral to support services should be offered in conjunction to providing a loan in order to provide the best option for helping the client meet their objective, especially if the lender was not able to provide the full amount of credit that is sought. This points to the need for ethical credit providers focused on social impact to be available in the market as an alternative.

Consideration should be given to extend this cap to include not only the current SACCS but also any consumer leases and credit contracts for household goods. This cap should better reflect the potential range a typical credit or lease commitments.

Question 10: National database (TOR 2.1)

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

- Is there sufficient information currently available for a SACC provider to meet the responsible lending obligations?
- If not, would a database or alternatives such as comprehensive credit reporting be a more effective way to meet the responsible lending obligations?
- If a SACC database is considered an effective method to meet the responsible lending obligations, please comment on:
  - the cost of a database;
  - any privacy concerns;
  - the advantages and disadvantages of having multiple databases operating in parallel;
  - whether a database would assist SACC providers to discharge the responsible lending obligations; and
  - the effect of the comprehensive credit reporting (CCR) regime, including whether or not additional information could be obtained through a SACC database that would not be available through CCR.

If a recommendation was made to introduce a database:

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

Foresters considers non-compliance to not be the result of insufficient information for lenders to do the right thing but the motivation to do so in light of running a profit producing business. In that context, we consider that the creation of a database specific to SACC loans will only increase the regulatory burden on the government and any costs directed at lenders which ultimately will be passed onto the consumer.

Foresters advocates that a COMPULSORY comprehensive credit reporting (CCR) regime to be the most effective way to enhance responsible lending through the provision of comprehensive and accurate information. A compulsory system creates a one-stop-shop providing the full commitments and balances of all outstanding loans (including NILS), both past and present, with the inclusion of items such as utility bills arrears etc. This regime could provide reliable and indisputable information for loan assessment for the lender and auditing/ investigation purposes similar to the SACC specific database. There is a distinct disadvantage to not having databases operating in parallel, such as the situation of having a SACC, CCR and NILS databases (plus any other such as in banking sector) in existence at the same time. Future efforts to reconcile these databases later will create confusion and additional cost.

The benefit of CCR system is that in additional to creating centralised information, it may also help individuals to create a positive reporting history and if made available to individuals free of charge on a regular basis (currently, once a year), this may help to improve individuals awareness about their financial position. It is foreseen that the compulsory regime can be run on a subscription basis, and that cost will be lowered with increased volume of data accessed. There are many ways that the cost structure to such a subscription can be set at a fair price across the industry, such as with a volume or tiered pricing model so that smaller providers are not disadvantaged from accessing the data and that larger players pay their fair share.

A comprehensive credit reporting system will also provide data and evidence on the real financial position of the community and lend weight to research into policy direction in the provision of credit and utility defaults in Australia. Currently we do not have a complete picture of personal debit and the effects of this that leads to financial exclusion. This data will resolve the macro issues discussion and allow for better policy development.

Question 11: Additional provisions for SACCs (TOR 2.2)

The terms of reference require consideration of whether any additional provisions relating to SACCs should be included in the Credit Act.

- Are there any additional provisions relating to SACCs that should be included in the Credit Act taking into account the objective of the legislation? For example, are there any provisions that have been effective in other jurisdictions that could be introduced?

Foresters does not recommend any additional provisions for SACCs other than some anti-avoidance addressed in question 12.

Question 12: Anti-avoidance provisions (TOR 2.2)

- Are stakeholders aware of any avoidance practices in relation to the Credit Act? If so, provide details of these practices and the scope (if known).
- Should any additional anti-avoidance provisions be included in the Credit Act?
  - If so, should there be any distinction between business model avoidance and internal avoidance?

There are two types 'business model avoidance' practices that we observe in our clients' experience with payday lenders prior to their enquiry at Foresters. We commonly observe the following loan structures:

Loan cycling

We see various loans set up as 6 week loans in order to maximise the opportunity to provide the client with a second loan within a 90 days period. For example, a $300 loan set up as 6 weeks term would cost the customer $84 in fees. That same loan set up over 12 weeks would be more affordable and a better option for the customer paying only slightly more in fees at $96. However the 6 week term is preferable to the lender because this would cycle into the next loan immediately, especially if the customer was short on cash as a result of making loan repayments, creating the opportunity for the lender to charge $84 twice over the 90 day period.

The probation on charging an establishment fee on any refinanced amounts is easy to avoid as loans can be repaid and new loan written on the same day. The order of the transactions can be difficult to track, and some may be a forced cycle of repeated borrowing.

Extending the term of the loan with split repayments

Also we also observe lenders taking the opportunity to "stretch" out loans in the second part of a split repayment schedule. Within the first part most of the capital has already been repaid so the extension is done to charge additional fees. For example, a $500 loan may be scheduled over 12 months, with the first 13 repayments at $50, followed by another 13 repayment at $10-15. We recommend that that changes are implemented to ensure all scheduled repayments are the same and that the monthly fee be capped as a percentage of the monthly scheduled repayment to ensure a uniform repayment schedule for the full term of the loan.

There is a distinction between business model avoidance and internal avoidance, but the latter is difficult to track and we have no information to provide at this stage.

Question 13: Documentation of suitability assessments (TOR 2.2)

The Credit Act requires lenders to make an assessment that the proposed SACC is not unsuitable.

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

- What is the most efficient and effective way to document suitability assessments? Is it possible to use the same steps for actual compliance and demonstrable compliance?
- Should SACC providers be required to document the assessment? Please consider whether such a requirement could lead to greater transparency.

Foresters considers the current responsible lending provisions to be appropriate and does not have any additional changes to recommend.

Normal loan assessment will include documented purpose and full financial position and suitability should be documented in an assessment that includes all appropriate details. Any short term cash

loans still need documentation around the purpose and suitability of the loan to meet the customer objectives. If the purpose is for the payment of a bill or invoice of some form then that should be documented and held on file.

For low income people for affordability assessment should contain detailed expenses as well as any commitments and not just rely on a benchmark or percentage ratio as often with a tight budget this is inappropriate.

As discussed, obtaining a loan on a marginal budget should require careful consideration, and consideration into alternatives besides obtaining a loan. Business models which make this process overly "quick and easy" by avoiding documentation for decision making does not practice due diligence fully and in some cases take advantage of vulnerable consumers without accountability.

Question 14: Comparable consumer leases (TOR 3)

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

- Which leases could be considered comparable with SACCs?
- Should there be greater consistency in the regulatory requirements that apply to SACCs and comparable consumer leases? Please consider:
  - the similarities between the consumer bases for SACCs and comparable consumer leases;
  - the similar economic outcomes of SACCs and comparable consumer leases;
- ASIC evidence[1] which suggests that the effective interest rate for some consumer leases is substantially greater than the maximum allowed for SACCs under the caps;
- the effect of introducing new regulatory requirements on the viability of the consumer leasing market and the availability of consumer leases; and
- the impact of the distinction based on whether or not the consumer has a right or obligation to purchase the leased goods.

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

As the provision of SACCs, consumer credit contracts on household goods and consumer leases the provision, assessment and marketing should all be the same.

The difference between credit contract and leases for similar items is very confusing for customers and leads to misunderstanding and confusion about the terms and rights under the contract.

All these forms of credit or leasing should have similar conditions and covered by a uniform regulation.

Foresters has come across contracts that are clearly exploitative of customers who are 'caught off-guard' or unaware. From our experience, it is not uncommon for us to observe customers who end up paying between 200-300% for original price of the goods they leased. For example, we had a customer who held a consumer lease contract and close to the end of this contract, received a letter advising the customer of the following options:

1. Option to pay $1 to own the item
2. Option to return to item
3. Option to continue paying for the item at an increase monthly rental – this would be the default option if the client failed to take action by the required date.

We consider this to be an exploitative practice taking advantage of low income individuals who may not be aware of their contract terms.

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

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

- Should there be additional disclosure requirements for comparable consumer leases, such as a requirement to disclose:
- the purchase or cash price of the leased good;
- the amount the consumer will pay in excess of the purchase or cash price;
- the cost of credit in dollar terms;
- the cost of credit as an interest rate; and
- the cost of other services financed through the rental payments (apart from the cost of hiring the goods, such as a warranty or delivery)?
- Please consider the cost of complying with any such additional disclosure requirements against the benefit of providing additional information to consumers.
- If greater consistency between SACCs and comparable consumer leases is considered warranted, which SACC provisions should be extended to those leases?
  - Would the SACC provision need to be modified when applied to comparable consumer leases?

Foresters considers that the same or very similar provisions should apply across both SACCs, credit contracts for household goods and consumer lease agreements. These include the following provisions:

- The same caps on cost should apply for items under $2000, namely, the establishment fee should not exceed 20% of the item and monthly fees of no more than 4% should be charged. Similarly, the total amount recovered should not exceed twice the cost of the original item. Any additional enforcement fees should be reasonable.
- Consumer credit contracts for household goods of any value or term should be capped at 200% of average market price of the goods.
- The same protection for Centrelink customers should apply to cap any repayments at 20% for customers who receive 50% of their income from Centrelink. Foresters suggests in addition that the same protection be extended to all Centrelink healthcare or pension card carriers.
- A warning sign should be visible through various mediums of customer contact, with information relevant to customers of consumers leases made clear to the customer. For example, the availability of NILS for purchase of household items, the option to get a Centrelink advance, the Government's money smart website on calculating the final cost of your item.
- The same loan assessment documentation should apply eg 90 days of bank statements and consideration of other commitments.
- Ownership of the item should be automatic and presumed once the contract date ends ie no difference between household item credit contracts and leases.

For disclosures the contract should clearly show the cash price (if paid upfront) and final price, with a comparative price to be provided. This text should be located on the front page of the contract and a copy provided to the customer free of charge, with a cooling off period to apply until the goods are delivered. Customer to sign next to information provided to acknowledge they understand there are cheaper options available.

The cost of providing the information on a credit contract or lease does not seem to be prohibitive as this is just part of a good business practice.

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

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

The cash price of the good is used as the basis for applying the cap on costs. Should the approach for sales by instalment also be used as a basis for applying the cap to leases that are comparable to SACCs? If so, how should the cash price of the good be defined?

If not, what alternative approach could be used to determine a cap on costs for leases?

Caps on leases should apply.

The average market price of similar items should be used to determine the "market price" and all lease total cost should be capped at 200% of this cost. This should apply to any household item or consumer goods for any value or term.

About Foresters Community Finance

As a Community Development Finance Institution (**CDFI**), Foresters is a socially focused organisation which uses community finance and social investment to generate financial returns as well as social, cultural, and environmental outcomes. Foresters is a financier and fund manager with a social focus. We provide loans to individuals who are underserved by mainstream financial institutions. We also provide business and property loans to non-profit organisations and social enterprises across Australia who are underserved by mainstream financial institutions.

Foresters raises and delivers capital to non-profits and social enterprises through its funds management company, Social Investment Australia. Social Investment Australia Ltd (SIA) a joint venture company with InterFinancial Corporate Finance Limited (InterFinancial). SIA holds Australian Financial Services Licence number 339844 and is the financier and fund manager for Foresters' investment products.

During the last forty-eight months Foresters has made over 1000 small consumer loans (under $4,000) totalling just under $1.5m to people excluded from mainstream financial institutions, and loans to over forty community organisations totalling over $7m.

Our Strategic Plan is centred around our vision, purpose and values to connect individuals, organisations and communities to help each other. Our innovative loan solutions aim to help individuals and social enterprises to improve their financial capacity and resilience.