Law Council
OF AUSTRALIA

Review of the Small Amount Credit Contract Laws

The Treasury

23 October 2015

GPO Box 1989, Canberra
ACT 2601, DX 5719 Canberra
19 Torrens St Braddon ACT 2612

Telephone **+61 2 6246 3788**
Facsimile +61 2 6248 0639

Law Council of Australia Limited
ABN 85 005 260 622
www.lawcouncil.asn.au

Table of Contents

Executive Summary **3**

Introduction 4

Objectives of regulatory framework 4

Complexity of the regulatory framework 5

Obligation to obtain and consider bank statements 5

Restrictions on repeat borrowing 5

Warnings and disclosure 6

Protection for Centrelink customers 7

Anti-avoidance 7

Consumer leases 9

Attachment A: Profile of the Law Council of Australia 11

Executive Summary

This submission responds to the *Consultation Paper: Review of the Small Amount Credit Contract Laws* (17 September 2015). The Law Council of Australia welcomes the opportunity to provide comments. This Executive Committee of the Australian Consumer Law Group (ACLC) in the Law Council's Legal Practice Section prepared this submission for the Law Council. It makes the following recommendations:

- credit providers be prohibited from lending to consumers who have an outstanding small amount credit contract (SACC) or who have held two or more SACCs in the past 90 days;
- SACC providers be required to disclose an annual cost rate in all disclosure documents and advertisements in the form that applies to other forms of consumer credit;
- for borrowers who receive 50% or more of their income under the *Social Security Act 1991* (Cth), not more than 10% of that income be permitted to be contributed to SACC repayments;
- a general anti-avoidance mechanism be enacted to support the effective operation of the national credit laws; and
- consumer leases be regulated in the same way as credit contracts so that cost caps and other protections associated with SACCs apply to consumer leases.

Introduction

1. The Law Council of Australia welcomes the opportunity to comment on the *Consultation Paper: Review of the Small Amount Credit Contract Laws* (17 September 2015).

2. This submission has been prepared for the Law Council by the Executive Committee of the Australian Consumer Law Group (ACLC) in the Law Council's Legal Practice Section.

3. The practitioner members of the ACLC take an interest in legal developments affecting consumers in the areas of superannuation, banking and finance, insurance, public health, personal injury and accident compensation. The ACLC liaises with government and non-government bodies involved in consumer law, including the Australian Plaintiff Lawyers Association, the Australian Competition and Consumer Commission, and the Consumer Affairs Advisory Council. The ACLC has a particular interest in the harmonisation of consumer protection laws across Australia.

4. The ACLC notes that the number of small amount credit contracts (SACC), commonly known as "payday loans", has increased significantly since the establishment of national credit licensing in Australia, and particularly since the passage of the *Consumer Credit and Corporations Legislation Amendment (Enhancements) Act 2012* (Cth). The Australian Securities and Investments Commission (ASIC) has estimated that the value of SACCs written in June 2014 had increased by 125% to about $400M as compared to 2008.[1] Despite this growth, consumer problems with payday lending persist.

Objectives of regulatory framework

5. The Consultation Paper asks for comment on how the regulatory framework should properly balance the competing objectives of consumer protection, access to credit and the viability of the industry. These objectives are not specified in the *National Consumer Credit Protection Act 2009* even though many other Acts include detailed objective sections with interpretative influence.

6. The ACLC has a particular interest in consumer protection. Some of the consumer concerns with the payday lending sector, and underlying the need for regulatory reform, include:

   - compliance with responsible lending requirements;
   - the very high cost of payday loans; and
   - the apparent efforts by some pay day lenders to avoid consumer protections.

7. It is the ACLC's view that consumer protection should be the primary objective of the credit regulatory framework.

[1] Australian Government, Australian Securities and Investments Commission, *Report 426: Payday lenders and the new small amount lending provisions* (2015), 7.

Complexity of the regulatory framework

8. The existing regulatory framework for credit is, in many respects, unnecessarily complex. The framework could be simplified without a reduction in consumer protections.

9. Sections 23A, 31A, 31B and 39A of the National Credit Code (Schedule 1 to the NCCPA) cap the fees and charges that may be imposed under a small amount credit contract. For example, under cl 31A(2) the maximum permitted establishment fee is 20% of the amount borrowed, and under cl 31A(3) the maximum monthly fee is 4% of the amount borrowed. This cap is a very generous to lenders. On an annualised basis, this converts to an interest rate of over 200% for a one month loan. A formula for calculating annualised costs is in cl 32B of the National Credit Code. Clause 32A(4)(b) provides that the 48% cap under the Code does not apply to small amount credit contracts. A lender charging the maximum fee on a $300, 30 day loan will recover fees of $72. By comparison, the interest charged on a $300 credit card cash advance would be around $4.50 after 30 days.

10. For credit contracts that are not SACCs, s 32A of the NCCPA provides that the maximum permissible rate of interest is 48%. The ACLC submits that applying this rate to credit contracts uniformly would be a simple and more effective regulatory measure. Applying one maximum permissible rate to all credit may reduce the need for the suite of regulatory measures that apply specifically to SACCs, including presumptions around loan suitability and the requirement to obtain and consider bank statements.

11. The ACLC recommends that the regulatory framework for SACCs be simplified by strengthening the cost cap provided for by the *National Consumer Credit Protection Act 2009* (NCCPA).

Obligation to obtain and consider bank statements

12. The obligation to obtain and consider a consumer's bank account statements for the previous 90 days at least, provided for by ss 117(1A) and 130(1A) of the NCCPA, is reasonable, especially in the absence of a stronger cost cap. The efficacy of this provision relies, however, on lenders considering the information to be properly informed and to make a responsible lending assessment. Further, even if a lender did obtain and consider bank statements, this may not provide complete information about the applicant's financial position. For example, some consumers have multiple bank accounts and may not disclose all relevant statements, and missed repayments may not necessarily be shown on bank accounts.

Restrictions on repeat borrowing

13. The rebuttable presumptions that a loan would cause "substantial hardship" where the consumer is in default under another SACC or has held two other SACCs in the past 90 days in ss 118(3A), 123(3A), 131(3A) and 133(3A) of the NCCPA appear to not be effective at preventing the risk of inappropriate repeat borrowing. ASIC, in its *Report 426: Payday lenders and the new small amount lending provisions*, found that nearly two-thirds of the 288 files reviewed indicated that the payday lender had entered into a

loan with a consumer who triggered one of the presumptions of unsuitability, with "8% triggering the default presumption and 54% triggering the multiple loan presumption".[2]

14. A key problem with the provision is that the law remains unclear about what information is required to rebut the presumption. From the ASIC report, it appears that some lenders ignored the rebuttable presumption and claimed to rely on their own responsible lending assessments. The problem with this approach is that ASIC also found poor compliance with the responsible lending obligations. Compliance problems included failing to record consumer's objectives and requirements for loans, and recording inconsistent information on files about borrowers' financial circumstances.

15. For the restrictions on repeat borrowing to be more effective, it would be simpler (both from a compliance and an enforcement perspective) for the restrictions to require strict compliance.

16. The ACLC supports prohibitions on lending to consumers who have an outstanding SACC or who have held two or more SACCs in the past 90 days.

17. The Consultation Paper asks whether the objective of limiting a debt spiral through repeat borrowing would be assisted by requiring SACC providers to rely on a recognised prescribed benchmark. The ACLC notes that the leading court decision on the NCCPA's responsible lending provisions, *ASIC v The Cash Store Pty Ltd (in liquidation)* [2014] FCA 926 (ASIC v TCS), found that for a lender to undertake "reasonable inquiries" about a customer's financial situation, that inquiry must include inquiries about the customer's current income *and* living expenses. While requiring SACC providers to rely on a recognised benchmark might reduce the likelihood that lenders advance loans inappropriately, this should not replace the existing requirement to assess a borrower's actual living expenses.

Warnings and disclosure

18. Sections 124B, 133C and 133CB of the NCCPA require lenders of SACCs to display a warning statement about the alternatives available to SACCs and the availability of other assistance to those in financial stress. The ACLC knows of no particular evidence that these warnings divert vulnerable consumers who might otherwise seek a SACC where it does not assist their financial wellbeing. However, we simply note that many financially desperate individuals will likely ignore warnings if the availability of a cash loan is seen to provide immediate relief to a financial problem.

19. Further, the ACLC notes the recent findings of the Financial System Inquiry which found that the regulatory framework that relies on disclosure alone has been insufficient to enable consumers to make informed decisions and consistently purchase financial products and services that meet their needs.[3] It found that consumers are often disengaged and do not invest the time to understand disclosure documents, and some consumers also lack the financial literacy skills. This is likely to be the case for many vulnerable consumers attracted to payday loans.

[2] Ibid 12.
[3] Australian Government, Financial System Inquiry Final Report (The Treasury, 2014), xx and Chapter 4.

20. The Australian Government on 20 October 2015 announced that it had accepted the vast majority of recommendations of the Financial System Inquiry, including those relating to disclosure.[4]

21. The ACLC notes that the framework for existing cost caps is unlikely to facilitate consumer understanding of the extent of costs imposed by SACCs. The maximum establishment fee of 20% of the amount borrowed and monthly fee of 4% of the amount borrowed do not require disclosure of a cost rate that would enable comparison with other forms of credit.

22. The ACLC recommends that providers of SACCs be required to disclose in all disclosure documents and advertisements an annual cost rate in the form that applies to other forms of consumer credit.

Protection for Centrelink customers

23. Regulation 28S of the National Consumer Credit Protection Regulations 2010 provides an additional layer of protection for borrowers who receive 50% or more of their income under the *Social Security Act 1991* (Cth). For these borrowers, repayments towards a SACC cannot amount to more than 20% of their periodic income.

24. The ACLC notes that this protection is at odds with the Centrelink Code of Operations, which is a voluntary agreement between banks and the Government. If a Centrelink recipient overdraws their bank account and receives income from a social security payment, banks agree to only contribute 10% of the social security payment to repay the overdrawn amount. This recognises that social security recipients require the vast majority of their income support (at least 90 per cent) to support their essential needs and wellbeing, and that only a small amount can reasonably be attributed to debt repayment.

25. The ACLC recommends that for borrowers who receive 50% or more of their income under the *Social Security Act 1991* (Cth), not more than 10% of that income be permitted to contributed to SACC repayments.

Anti-avoidance

26. The ACLC notes that the payday lending sector has a long history of initiating avoidance strategies, that is, implementing contractual or other techniques to avoid consumer protection legislation.

27. An example is the Cash Converters class action initiated by Ms Julie Gray, a repeat borrower. In this action, Ms Gray alleged that certain deferred establishment fees breached clause 7 of Schedule 3 of the *Credit (Commonwealth Powers) Act 2010* (NSW) which limited the fees and interest that could be charged by lenders in NSW. The allegation was that the lender constructed the loans so that the deferred establishment fee would be charged in respect of nearly every loan. The class action was provisionally settled in June 2015, without admission of liability, but with Cash Converters agreeing to repay $23M.

28. The recent decision of *Australian Securities & Investments Commission v Fast Access Finance* [2015] FCA 1055 is another example. In this case, ASIC claimed that the

[4] Australian Government, Improving Australia's financial system: Government response to the Financial System Inquiry (2015).

Fast Access Finance (FAF) companies constructed a business model which was deliberately designed to avoid the protections offered by the NCPPA, including the cap on interest charges. Consumers who were seeking small value loans (of amounts generally ranging from $500 to $2,000) entered into contracts that purported to be for the purchase and sale of diamonds in order to obtain a loan. Consumers in ASIC's case were completely unaware of the actual nature of the contracts into which they were entering and assumed that they were obtaining a traditional loan.

29. The Federal Court found that the true purpose of the contracts was to satisfy the consumer's need for cash and the FAF companies' desire to make a profit from meeting such a need. The provisions in the contracts for the sale and resale of diamonds added nothing to the transaction. The effect of these contracts was to charge interest well in excess of the 48% interest rate cap that should have applied to these types of loans.

30. However, ASIC has not always been successful in its court actions seeking to deal with avoidance practices. In *Australian Securities and Investments Commission v Teleloans Pty Ltd* [2015] FCA 648, the Federal Court dismissed a bid by ASIC to shut down the short-term lending business accused of avoiding consumer protections.

31. The action involved two companies; Finance & Loans Direct Pty Ltd (FLD) and Teleloans Pty Ltd (Teleloans). According to ASIC, FLD and Teleloans were breaching the National Credit Code because separate agreements that FLD and Teleloans entered into with a borrower were in reality a single credit contract, and the total fees collected from the customer under those two agreements exceeded the National Credit Code's cap on charges that may be recovered under a "credit contract".

32. The Court held, however, that Teleloans was a "helper" who provides a service, as opposed to credit, and provides that service as an agent of the customer. As such the only credit provided was under the loan agreement between FLD and its customer. The Court noted that there was no general anti-avoidance provision in the National Credit Code, and the particular provisions aimed at specific avoidance activity did not apply to the case before the Court.

33. The ACLC notes that in 2013, the Australian Government consulted on draft legislation that would have, if enacted, introduced a general anti-avoidance provision into the national credit laws. The regulatory impact statement (RIS) accompanying this bill stated that the history of credit regulation in Australia has also been the history of credit avoidance, noting that avoidance can be the result of:

    - conduct by serial self-exempters deliberately electing to avoid the consumer credit protections completely;
    - innovations in product design; or
    - structuring the transaction so that the provider is subject to a lower form of obligations while still subject to the NCCPA.[5]

34. The RIS recommended implementation of the general anti-avoidance provision, noting that it would deliver benefits to those consumers through changes to practices such as clearer and uniform disclosure of costs, greater accountability of providers through access to external dispute resolution scheme (EDR schemes), and ongoing

[5] Australian Government, *Regulation Impact Statement, Phase Two of the National Credit Reforms: Addressing Avoidance of the National Consumer Credit Protection Act 2009* (2013)

obligations on fringe operators to meet and maintain the standards necessary to hold an Australian Credit Licence.

35. The ACLC recommends that a general anti-avoidance mechanism be enacted to support the effective operation of the national credit laws.

Consumer leases

36. The ACLC notes that there have been similar consumer concerns associated with consumer leases as with payday loans. Consumer problems include targeting of borrowers who are unable to afford the lease arrangements and high costs associated with the loans. In the last two and a half years, ASIC has taken enforcement action against eight consumer lease providers, largely in relation to responsible lending. It has also released a report which demonstrated that lease providers are charging high costs and delivering poor consumer outcomes.[6] More specifically, ASIC found:

- the highest price charged by a lessor, expressed as an interest rate, was 884% (for a clothes dryer);
- that consumer leases can cost as much as five times the maximum amount permitted under a payday loan, where a cap on costs applies; and
- that consumers receiving Centrelink payments are being charged much higher prices than the prices advertised by lessors.

37. The ACLC notes the analysis from Paul Ali *et al*[7] which finds that the regulatory distinction between "credit contract" and "consumer lease" is flawed, and has created opportunities for regulatory arbitrage—that is, an opportunity for businesses to manipulate the structure of their contracts to exploit a difference between the substance of the transaction and its regulatory treatment. The analysis notes that lease providers have designed contracts which are in substance credit contracts but are only regulated as consumer leases. This has "led to numerous instances of lessors actively misleading consumers about whether they would obtain ownership of the goods at the end of the lease".[8]

38. Ali *et al* explain a number of methods lessors have used to ensure that consumers can effectively accrue a right to own the goods being leased (like a credit contract), but still be regulated as a consumer lease. For example, lessors may provide that the consumer has a right to purchase "similar" goods to the ones being leased, or that consumers can request that the goods to be given as a gift to their spouse.

39. The authors explain that these practices have led to consumer detriment and higher costs:

> *…lessors could in effect, contract out of the higher costs associated with more heavily regulated leases… In addition, the substantially lower disclosure requirements applicable to consumer leases and the absence of those requirements in the case of exempt leases significantly impeded the ability of consumers to ascertain the cost of those types of leases and, consequently, to compare leases with alternatives. This very likely led to consumers paying more under their leases*

---

[6] Australian Government, Australian Securities and Investments Commission, "ASIC finds the cost of consumer leases can be as high as 884% 15-249MR" (September 2015)
[7] Paul Ali, Cosima McRae, Ian Ramsay and Tiong Tjin Saw, "Consumer Leases and Consumer Protection: Regulatory Arbitrage and Consumer Harm" (2013) 41 *Australian Business Law Review* 240.
[8] Ibid 241–243.

than they might otherwise have been prepared to do … It is unsurprising that consumer leases are relatively expensive for consumers and have generated significant returns for lessor.[9]

40. The authors propose that the Code should abandon the "right or obligation to purchase" distinction and instead distinguish between "true leases" and "finance leases":

- In a "true lease", the business providing the lease retains title to the goods as well as most risks and benefits incidental to ownership. True leases are of a short term compared to the useful life of goods, as they are intended to be returned and leased out again to other consumers. Typically the amount paid for lease will be less than value of product.
- In a finance lease, the lease provider retains title to the goods, but the lessee shoulders the risk, including depreciation. Finance leases usually last for the whole or a major part of the useful life of the goods, and the consumer pays an amount in excess of the value of the goods. This being so, the consumer is in substantially the same position as a person buying the goods on credit except that they do not obtain title.[10]

41. The authors propose that finance leases should be regulated in the same way as credit contracts, and true leases should not be regulated by credit regulation at all. This would ensure that regulation focuses on the substance of the transaction rather than its form, and avoids having parallel regulation for different finance leases depending on the arbitrary distinction of whether or not they provide a right or obligation to purchase. The exemption of "true" leases from regulation under the credit code is effectively already in place, because the Code does not regulate leases where the amount paid by the consumer is less than the value of the goods.

42. The ACLC agrees that it is difficult to argue that consumer leases and credit contracts are in some way so different that they are deserving of separate regulation.

43. The ACLC recommends that consumer leases be regulated in the same way as credit contracts so that cost caps and other protections associated with SACCs apply to consumer leases.

[9] Ibid *266*–26*7.*
[10] Ibid 243–245.

Attachment A: Profile of the Law Council of Australia

The Law Council of Australia exists to represent the legal profession at the national level, to speak on behalf of its Constituent Bodies on national issues, and to promote the administration of justice, access to justice and general improvement of the law.

The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world.

The Law Council was established in 1933, and represents its constituent bodies consisting of 16 Australian State and Territory law societies and bar associations and Law Firms Australia. The Law Council's Constituent Bodies are:

- Australian Capital Territory Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar
- Law Firms Australia
- The Victorian Bar Inc
- Western Australian Bar Association

Through this representation, the Law Council effectively acts on behalf of more than 60,000 lawyers across Australia.

The Law Council is governed by a board of 23 Directors – one from each of the constituent bodies and six elected Executive members. The Directors meet quarterly to set objectives, policy and priorities for the Law Council. Between the meetings of Directors, policies and governance responsibility for the Law Council is exercised by the elected Executive members, led by the President who normally serves a 12 month term. The Council's six Executive members are nominated and elected by the board of Directors.

Members of the 2015 Executive as at 1 July 2015 are:

- Mr Duncan McConnel, President
- Mr Stuart Clark, President-Elect
- Ms Fiona McLeod SC, Treasurer
- Mr Morry Bailes, Executive Member

The Secretariat serves the Law Council nationally and is based in Canberra.