Review of the small amount credit contract laws

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As recognised researchers in the field of consumer finance we welcome the opportunity to outline for panel members our key observations and findings about the Australian SACC and consumer lease markets.

In responding to each question, we are especially mindful of sections 4 and 5 of the Review's Terms of Reference. Our submission is particularly informed by an understanding that the Review will take into account fairness and a consumer's access to finance (in TOR 4) and whether the current policy settings will continue to meet Australia's evolving needs (TOR 5).

Research of the Australian small loan and consumer lease markets has been severely hampered by the lack of industry-wide datasets specifying, for example, the number of loan/lease contracts written, revenues received, customer profiles and borrowing/leasing frequencies, default rates and these sectors' employment levels. Recent studies have therefore been based on secondary data such as company reports, or customer surveys and interviews with industry stakeholders (Banks et al. 2012; Banks et al. 2015a; Connolly et al. 2011; Gillam 2010).

The main thrust of our comments is that attempts to balance the dual regulatory goal of enhancing public goods (consumer protection) and facilitating the viability of these industries is placed at increased risk by a poor understanding of:

- how Australians - especially low-income Australians - access credit, and
- the complex dynamics of the broader consumer credit market.

Our contribution is primarily focused on responding to questions in Sections 1 and 3 to provide further context about:

- how consumers of Alternative Financial Services products incorporate small loans and consumer leases into their wider money management practices, and
- the interaction effects between industries within this broader consumer credit market

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Question 1: Competing objectives

An evidence-based response to this complex question firstly requires responding to a set of more specific questions:

- Who is the consumer?
- How do consumers of SACCs incorporate this product into their broader debt and credit obligations?
- What options do consumers - especially low-income consumers - have to access credit?
- What factors are involved in how SACC providers may viably incorporate this product into their current and future business operations?
- How is the highly innovative and fluid SACC market situated within the wider consumer credit market?

There are two emerging academic insights that frame our responses to these questions.

1. SACC products and consumer leases need to be understood as forming part of what has been termed the Alternative Financial Services (AFS) market (Stoesz 2014). In a recent paper (Banks et al. 2015a) we outlined this market's key characteristics:

> *The AFS market is comprised of firms usually offering multiple lines of services and products to meet the needs of low-income and precariously employed households: payday loans, pawnshop services, rent-to-own household products and other forms of consumer leases, in-house used car loans, 'check-cashing' services (especially in the United States) and low-income insurance products (Stoesz 2014).*
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> *Some analyses consider that the AFS market has a 'countercyclical' relationship to economic conditions, in that higher levels of poverty are the main drivers for demand (IBISWorld 2015). Poverty factors are important, however the complexities of the market cannot be reduced to this metric. Susan Soederberg (2014) and David Stoesz (2014) highlight that there are more geographically and institutionally specific dynamics at play, such as the prevalence and characteristics of a country's casual labour markets, domestic consumer protection laws, local variations in social welfare provision, the regulatory environment within which financial markets operate, as well as the levels (and changes) of income inequality.*
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> *….In response to these complex risk factors, different, and overlapping, sub-markets have emerged. In most developed countries, for example, the thriving online loans market restricts its products to consumers who have at least some paid employment, whereas the storefront market is more tailored to issuing loans to lower-income and unemployed customers. Most payday firms have specialised, multiline business models designed to offer particular products, such as pawnbroking and payday services, brokering services, or a suite of vertically integrated loan options that extend from low-margin, high volume and higher-risk small loans to higher-margin, lower-risk unsecured and secured credit valued in the thousands of dollars.*

For example, SACC loans generate a significant but minority component of Cash Converter's complex income streams. Revenue from personal loan interest and establishment fees (which include both SACC and MACC type products) account for about 42% of company revenue, with second hand good sales (34%), franchising fees, commissions, pawnbroking services and vehicle leasing and trade sales constituting the majority of revenue streams (Cash Converters 2014: 46).

2. In engaging with Australian AFS sub-markets many low-income citizens are exercising constrained choices within the mixed economy of credit based on the location of different credit providers, cost, eligibility, speed and knowledge of available options. The mixed economy of credit is a term used by Marston and Shevellar (2014) to describe the different costs and calculations involved in making decisions about borrowing money from the (1) private sector, (2) the state, (3) family and friends or (4) through non-government microfinance schemes.

Research has shown that many low-income consumers prefer the anonymity of payday loans to borrowing from family, friends or welfare agencies (Banks et al. 2015b; Rowe et al. 2014). As we describe in a recent (Banks and Marston 2015) chapter on global trends in unsecured credit:

> *This economic and geographical calculus is occurring within each citizen's 'debtscape' (Walks 2013). It is a personal reckoning also influenced by emotional and moral dimensions, as in the feelings of shame or guilt that may be associated with asking parents or friends for a short-term loan in Anglophone countries where economic independence is a marker of a successful transition to adulthood (Marston and Shevellar 2014). In this instance, the financial cost may indeed be low, with little or no financial interest charged for the loan, yet the emotional cost associated with taking the loan may be very high. As one of the young women we interviewed in regional Queensland said, 'I could never go to my father to ask for money, he would probably give it to me, but would give me hell for asking'. As this example highlights, each citizen must weigh up the different transaction costs among a constrained set of choices. The emotional dimension of decision making with the mixed economy of credit is therefore an important, but often neglected, element in understanding how individual decisions about credit are made (Collins 2004).*

To illustrate how the mixed economy of credit is practiced by low-income consumers we provide this recently published case example (Banks and Marston 2015) based on research conducted prior to Australian legislative changes that occurred in 2013:

> *Maryanne's weekend night shift job cleaning a sporting stadium was manageable until the previous year when her ex-partner found looking after the boys for a couple of days a week 'too much'. Eking out social welfare payments and using a flexible set of financial tactics worked for Maryanne '90 percent of the time'. The clothes dryer and the boys' Xbox were rented for $24 a week. Christmas presents were being paid down through 'layby'—an arrangement whereby a store sells you an item but holds onto it until you've paid it off in regular instalments. Credit cards were cut up. As Maryanne put it,*
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> *They're high interest—but it's not the interest though. It's the fact that, if you've got a credit card you're always going to use it, you know. Like if we're low on money and we need to do shopping, if we've got $100 in my purse, that's what we're going to spend. But if we've got a credit card that's sort of like an infinity bucket.*
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> *…For the other 10 percent of the time when things weren't working out financially, another financial scheme had been brought into play—taking out small loans from one of her many local 'payday' lenders, which get their name from the fact that loans are deducted from*

clients' accounts on the day they are paid by employers or welfare. It started four years earlier: 'I think it was just one week I had paid all the bills and there was no shopping, and with four boys, there's got to be food in the house, otherwise there's going to be a war'. Initially Maryanne's practice was to borrow $500 and pay back $200 a week over four weeks. By the end of the fourth week 'I'm broke again, I've got to go get another loan. And it just continued and continued and continued for a long time'. Last year she changed companies and now borrows $800 over a three month period, which only costs her $90 a week. As she explained: 'No money gets wasted in this house. But when we do get these smaller loans, it's generally because we're running low on things or we're getting behind in a bill, and if it's not, it's generally for one of the kids' birthdays'.

In a report commissioned by the Australian Centre for Financial Studies (Banks et al. 2015a) we listed four key characteristics of SACCs that made them an attractive option for low-income consumers to incorporate into their mixed economy of credit:

- The credit comes in the form of cash, either as physical notes or a deposit in a bank account;
- There is fast access to this cash;
- There is a relatively low emotional or psychological cost to the borrower, compared to other forms of credit; and
- There is a comprehensible and relatively simple repayment cycle that is aligned to a borrower's income flow, minimising their financial exposure to more indeterminate and risky debt repayment options such as credit cards (Banks et al. 2015b; Bhutta et al. 2015; Carter 2015; Soederberg 2014).

The final dot point requires further elaboration:

How consumers of small loans (and other AFS products) assess financial suitability has a critical bearing on their engagement with the Alternative Financial Services market. Total cost is obviously one key determinant of whether a particular form of credit is suitable compared to lower-cost alternatives. However, ***time*** *is an equally important dimension. This aspect of consumer behaviour–especially for low-income households–strongly aligns with the sociology of money literature that finds poorer households have very distinctive money management practices.*

For example, in her study of Swedish and Danish households, Pernille Hohnen (2007: 758) persuasively argues that financial timescales in low income households are not only far shorter than those in middle class families but are of a 'different kind'. Higher levels of income tend to structure 'financial time' as more distant and abstract in average-income families, who experience little of the cyclic spending patterns in lower-income households whose receipt of small monthly payments concretely alter the value of money in the latter weeks of the month as their finances tighten (pp. 758-760)

Hohnen's (2007: 758) pertinent observation that income levels influence scale and quality of the 'time of money' supports research conducted by [RMIT][1] … that found lower-income participants tended to talk about money in more immediate and fortnightly terms than average-income participants. This factor is highly relevant as low-income consumers tend to assess affordability of credit by periods that conform to their fortnightly receipt of Centrelink payments (Banks et al. 2015a: 26).

[1] ARC Discovery Project 110103808 'What women need: unravelling the factors underlying women's financial decision-making behaviour'.

As Table 1 shows, other AFS credit options either:

- Do not exhibit the four characteristics that, in combination, make SACCs uniquely attractive to low-income consumers[2]; or
- Are not accessible to these consumers[3]

Table 1. Comparing the four key characteristics that attract low-income consumers to payday loans with credit alternatives

Credit Alternative	Access to cash	Fast transaction	Low emotional cost	Regular and clear cut repayments
Family and Friends	Likely	Somewhat unlikely	Unlikely or unavailable	Unlikely or unavailable
Centrelink Advance	Likely	Somewhat unlikely	Somewhat unlikely	Likely
Pawnbroking	Likely	Somewhat unlikely	Somewhat unlikely	Somewhat unlikely
Social Microfinance (NILS)	Unlikely or unavailable	Unlikely or unavailable	Unlikely or unavailable	Likely
Consumer Lease	Unlikely or unavailable	Likely	Likely	Likely
SACC Storefront	Likely	Likely	Likely	Likely
SACC online	Unlikely or unavailable	Unlikely or unavailable	Unlikely or unavailable	Unlikely or unavailable
Interest Free Purchase	Unlikely or unavailable	Unlikely or unavailable	Unlikely or unavailable	Unlikely or unavailable
MACC	Unlikely or unavailable	Unlikely or unavailable	Unlikely or unavailable	Unlikely or unavailable
Credit Cards	Unlikely or unavailable	Unlikely or unavailable	Unlikely or unavailable	Unlikely or unavailable
Secured Loans	Unlikely or unavailable	Unlikely or unavailable	Unlikely or unavailable	Unlikely or unavailable

Likely	Somewhat unlikely	Unlikely or unavailable

Source: (Banks et al. 2015a)

We contend that applying these two frameworks, namely (a) the Alternative Financial Services market, and (b) consumer engagement in the mixed economy of credit, is crucial for developing an adequate evidence-based assessment of how to strike a regulatory balance between protecting the needs of different actors in the SACC and consumer lease sub-markets.

[2] For example, NILS products are a cheaper alternative than a commercial small loan, but do not meet three of the four dimensions that attract consumers to commercial small loans: cash is not provided as the loan is tied to a product or service; the loan process is complicated and slow; and applicants often perceive that the welfare aspects of the application process may expose them to a higher emotional cost than commercial loan procedures.

[3] For example, over 90% percent of storefront small loan borrowers in Australia, the United States and the United Kingdom either do not have a credit card or have no credit on their card Marcus Banks et al., 'Caught Short. Exploring the Role of Small, Short-Term Loans in the Lives of Australians. Final Report', (Brisbane: RMIT University, The University of Queensland, Queensland University of Technology, Good Shepherd Youth and Family Service and National Australia Bank, 2012), Marcus Banks, Ashton De Silva, and Roslyn Russell, 'Trends in the Australian Small Loan Market', *Research Grant Funded Articles* (Melbourne: Australian Centre for Financial Studies, 2015a), Sarah Beddows and Mick Mcateer, 'Payday Lending: Fixing a Broken Market', (London: The Association of Chartered Certified Accountants, 2014), Ibisworld, 'Check Cashing & Payday Loan Services in the Us', (2015), Pew, 'Payday Lending in America', (Washington, D.C.: The Pew Charitable Trusts, 2012).

Basic research of what these needs may be requires contextualizing firm and consumer interactions with the total AFS market *prior* to analysing their specific engagements with the SACC and consumer lease sub-markets. To date there has been no research of:

- the scope and scale of the Alternative Financial Services market in Australia;
- the overall impact on consumer welfare through accessing AFS products and services;
- the horizontal and vertical synergies available in business models operating within and across AFS sub-markets.

3. The post-2013 regulatory environment.

Even though research of the Australian small loan market has been severely hampered by the lack of an industry-wide dataset, there are a number of studies that show significant changes in the industry and a continuing strong demand for SACCs since the implementation of the 2013 regulatory regime:

> *As a key player in the thriving Alternative Financial Services market, the small loan sector is responding to the demand for credit by large numbers of Australians working in secondary labour markets or reliant on Centrelink payments. This demand is largely unmet by traditional financial institutions and is unlikely to be met given the pressures of the Basel Accords towards raising capital requirements. The industry has consolidated from about 280 small independent operators in the mid-2000s to 30 in 2015 (Bryant 2015).*
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> *Since government regulation in 2013, the sector has responded through innovation in product design, new risk assessment techniques and technologies, marketing and delivery and shows continued signs of growth. These trends include: the decline of some small independent providers; the consolidation of major payday providers; the emergence of split markets between low-income high street borrowers and a thriving online sector which caters for somewhat higher income earners; internationalisation; and moves that integrate the payday sector with other segments of banking capital and retail finance.* (Banks et al. 2015a)

Further trends also include extended loan periods for SACCs, greater vertical and horizontal integration with other AFS sub-markets, and the emergence of a new lead-generator market (see below). An analysis of these changes, including a desk review of the three ASX listed companies with a presence in the SACC market, can be found in our paper 'Trends in the Australian Small Loan Market' (Banks et al. 2015a). The excerpt below focuses on the growth of the online SACC market.

> *Nearly all Australian lenders have an online presence and only some have retail stores. Industry stakeholders estimate that 70% of SACC loans are currently transacted through storefront providers and that online SACCs will constitute 50% of the market within three years. Due to their distinct models and customer bases, different risk mitigation strategies are applied by storefront and online lenders. For example, a new customer applying for a loan in a retail outlet is commonly provided a very low first loan–typically $50 to $100–to assess their capacity to repay. Slightly more may be lent on the second or third application as the staff get to better know the customer's circumstances.*
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> *Longer-term credit relationships may include 'migrating' a customer's credit options to include MACC or secured loans. The risk approaches adopted by online lenders is quite different. Software–often developed in-house–assesses risk and complies with Responsible Lending Obligations through the customer's online application, interrogating their account history, and evaluating the customer's circumstances through investigating their social media interactions. The software algorithms, which are calibrated to minimise risk, reject*

approximately 90% of applications in Australia. Online lenders on-sell the data in the rejected applications as 'lead-generators' to other lenders willing to take on higher-risk customers and to other markets such as consumer product retailers. One leading online industry stakeholder estimates that the lead-generation market is now larger in Australia than the small loan market.

From a demand perspective, research suggests that since the introduction of the 2013 regulatory regime growing indebtedness, increasing levels of income inequality, growing secondary labour markets and precarious employment, and rising levels of poverty continue to underlie and drive low-income consumers' constrained credit choices (ACOSS 2014; Banks et al. 2015a; Healy 2015). A 2015 study found that the ratio of average debt to disposable income for low economic resource Australian households has sharply risen over the last decade. In 2005 average low-income household debt represented 0.6 years of income. In 2015 it represented 1.1 years of disposable income (Bankwest Curtin Economics Centre 2015: 43). As this Review has broadly accepted, international studies consistently show that store-front borrowers of SACC-type loans are in the bottom or second-to-bottom income quintile.

Australian research of consumers accessing small loans through high street lenders is based on small surveys and is now quite dated. Our 2012 Australian study found that 78% of store-based borrowers were in receipt of a Centrelink income support payment or pension (Banks et al. 2012). There is no available research of store-front SACC consumer income levels in the current regulatory environment.

Consumers of online loans constitute a separate market. Online-only providers of SACCs in Australia, due to less refined risk assessment methods than those used by store-front providers, only lend to lower-risk borrowers who are employed. These consumers would therefore be expected to have somewhat higher incomes than store-front borrowers (Ali and Banks 2014). A pilot survey (N=127) we conducted in August 2014 with two major lenders of online SACCs nevertheless found that many of their SACC applicants (who may have been unsuccessful in gaining a loan) had low incomes, with 55% of applicants recording an annual income of less than $30,000 and a further 19% an income of less than $50,000. However, a major Australian online-only lender we interviewed for this study estimated that *accepted* loan applicants' average income was $54,500 (Banks et al. 2015a).

Demand for SACCs appears to remain high in the post-2013 regulatory environment. While robust industry-wide data is currently not available, all three ASX-listed firms with a significant presence in the SACC market (Cash Converters, Money3 and Credit Corp) have reported strong demand for SACCs and MACCs (Bryant 2015; Cash Converters 2014; Credit Corp 2014, 2015; Money3 2014). A small survey of Victorian financial counselors (N=49) jointly conducted by RMIT and the Financial and Consumer Rights Council in early 2014 supports the view that SACC demand has not lessened in the post-2013 regulatory environment. We found that SACC loans taken out by consumers seen by financial counsellors had either increased or stayed the same.

Regardless of the platform or particular strategic approach, firms with a current SACC exposure continue to predominantly derive their SACC revenue from repeat customers. Lenders we interviewed in 2014 and 2015 for various studies invariably observed that more than 70% of both their online and storefront consumers were regular customers. Our survey of online SACC applicants conducted in August 2014 confirms these claims, with only 18% of respondents indicating that they had only taken one SACC loan in the last two years. The majority of respondents had borrowed 2-5 SACCs (51%) or more (31%) in the last two years – a very similar borrowing frequency pattern to that found in our pre-2013 regulations study (Banks et al. 2012: 37).

As we have previously noted (Banks et al. 2015a) SACCs are primarily used to meet day-to-day expenses:

> *The demand for small, short-term loans is driven by cash-poor and / or low-income consumers who have immediate financial needs. The promise of 'fast cash' is the small loan industry's key point of difference in the AFS market. These loans are mostly used by customers to pay for recurring expenses (Schmitz 2014: 71). Australian and international studies of the small loan market consistently show that the most common reason for taking out a small loan is not to pay for a 'one-off' expense but rather to cover some of the unmet costs of bills, food or other regular outlays (Banks et al. 2012; Beddows and McAteer 2014; Burtzlaff and Groce 2011). Research by Pew in the United States shows that 69% of store-front borrowers and 73% of online consumers used their loan to cover a recurring expense, such as utilities, credit card bills, rent or mortgage payments, or food (Pew 2012).*

While recent Australian data is unavailable, the 2012 report 'Caught Short' found a very similar proportion of shop-front consumers (68%) took out a loan for day-to-day living, rather than one-off expenses (Table 2).

Table 2 Aggregated reasons for taking out a loan (N=112) (Regular expenses in tan)

To pay a bill	44
Had no money/not enough money	32
To buy food	29
To pay back another loan	21
To buy things for the kids, childcare or schooling costs	21
Medical (pharmaceuticals or regular hospital expenses)	18
Car repairs, maintenance, registration, repayments or fines	18
Housing (rent)	14
Household appliances and furniture	13
For gambling or due to gambling	12
Travel expenses	10
To lend money to another person	9
To buy birthday or Christmas presents	9
Housing (bond or relocation expenses)	8
Clothing or shoes	6
Car purchase	5
Entertainment (eg holiday or night out or books or CDs)	4
Other irregular expenses	22
Other regular expenses	26
Total regular expenses	**217**
Total irregular expenses	**104**

Source (Banks et al. 2012)

On one hand, the costs for many consumers' engagements with unsecured small loan markets can be very high. We estimated that in 2012 approximately 1.1 million Australians were, on average, taking out three to five loans per year, generating SACC-type contracts estimated to be valued between $800 million and $1 billion. An estimated 40% of payday loan customers had far heavier borrowing practices–taking out more than 10 loans per year. Overall, two-thirds of participants in the study were essentially in a state of continual indebtedness to one or more short-term, small-loan companies for considerable periods of time (Banks et al. 2012). While many SACC customers experience financial hardship due to the fact of being poor or in precarious employment, those who chronically borrow are often placed at greater risk of hardship (Banks et al. 2015).

On the other hand, consumers of small loans interviewed for the 2012 report 'Caught Short' strongly argued that until other, cheaper and as easily accessible credit options became available they felt they needed to continue to rely on this industry. Many borrowers did not like needing to take out loans but also felt if the loans did not exist they would have far fewer options. Only a minority of participants – less than one-fifth of the sample – thought the short-term lending industry should be abolished. A Melbourne participant receiving a student support payment commented about small loans:

> *In a perfect world it would be great if they didn't exist because then people would have enough money – there wouldn't be that desperation. I mean as long as there's that desperation and people aren't earning enough to support themselves, there's always going to be those people that are going to prey on that need. So, it's like a necessary evil . . . I think that they're filling a gap that the welfare state isn't providing.* (Banks et al. 2015b)

We contend that, within its Terms of Reference, the Review's attempts to find some balance between the dual regulatory goals of enhancing public goods (consumer protection) and facilitating the viability of the SACC industry are heavily constrained by:

- An insufficient policy knowledge of what may constitute a public good (consumer protection) in this market. Protection measures that misunderstand how low-income consumers engage in the mixed economy of credit may have unintended consequences that weaken rather than enhance public goods. Further research is sorely needed about the *overall* exposure to the risk of financial hardship among low-income households who engage in the Alternative Financial Services market when seeking credit.

- Poor knowledge of the current SACC market and especially how this industry connects with the broader Alternative Financial Services market. For the Review to find a balance between its two goals assumes knowledge of the dynamism of the SACC market, what would constitute a viable SACC revenue stream, and how value can be leveraged from SACC markets to other AFS markets. There is little transparency in this market (or other AFS markets) and therefore any policy changes would not be based on sufficient evidence and thus too reliant on the views of rent-seekers.

We strongly suggest that the Review also recognises that regulations that simply address market-based issues in this sector are insufficient. A broader understanding is required that growing inequality and poverty are the crucial drivers for the high demand for small loans (Montgomerie and Packman 2014).

Question 2: Complexity

Our core contention is that firms offering SACC products operate as a component of the AFS market. Any proposed changes to the currently regulatory regime (such as including elements of consumer leases into the new regulations) can only be partial policy responses to enhancing public goods and facilitating viable markets until there is a broader regulatory regime for the AFS market as whole.

Therefore, within the Terms of Reference of this Review, we are hesitant to suggest simplifications to the current regulatory regime pending a greater understanding of the Australian AFS market and consumer engagement in it.

Question 3: Sanctions

We have insufficient understanding of how the sanctions regime is working to comment.

Question 4: Obligation to obtain and consider bank account statements

We have an insufficient understanding to comment if SACC providers adequately interrogate bank statements in their assessment of whether a consumer contract may be 'unsuitable', nor how bank statements are included in a provider's overall risk assessment of a SACC application.

However, more general comments can be made about SACC firms leveraging value from data supplied by consumers (including bank account details), and consumer data independently sourced by providers (including an applicant's social media profile). There is an increasingly innovative use of big data to build richer customer profile databases which some major lenders are progressively leveraging as a way to enter markets for other risk-based consumer finance products such as insurance. This business trend has been developing in the United States for nearly a decade (Consumer Federation of America 2009).

Data gathered by SACC providers, including both declined and accepted loan applications, has value in other markets:

> *One facet of the payday industry that has not been widely discussed is the continued growth of 'lead generation' websites as an adjunct to the online sector. Lead generators often market themselves as online payday lenders or present as loan comparison sites, but they do not lend and as such do not require a credit license. Instead they sell the information of applicants, using a bidding platform, to lenders in the market. Some lenders also act as lead generators, monetising declined applicants by referring them to other lenders. Leads are processed through the lender's LMS software to determine suitability, such as a customer's credit rating and default history. The 'quality' of the lead generates higher prices, but determining the exact basis and measure of 'quality' is difficult as there is considerable variation between lenders on risk allocation and other lending criteria. According to a leading online-only lender, the average price for a lead is $90 to $120, though successful lead bids range from $2 to $350.*

Our study found that the big players in lead generation include 9global (a US-based company), Vibration media, and finder.com.au. In the US, lead generation business has biannual conferences of up to 15,000 participants, indicating that it is a significant industry in its own right. Our research on lead generators operating in the Australian online SACC sector found 55 sites. Most lenders we interviewed expect the lead generation sector to grow rapidly in Australia.(Ali and Banks 2014)

Question 5: Restrictions on repeat borrowing

From an industry perspective, establishing a habit of repeat borrowing is a common characteristic of all small loan business models. Because start-up costs are high and margins low, SACC revenue lines only tend to become profitable after the second or third loan (Banks et al. 2015a). These Customer Acquisition Costs (Beddows and McAteer 2014: 17)—checking a customer's credit history, filling out a ream of paperwork, advertising, sourcing underwriters to finance the business and so on—are higher than the relatively small amount of extra money that the borrower initially repays. It is only after the first few loans are profits made, and establishing strong customer relationships is therefore crucial:

A Melbourne payday sole proprietor we interviewed expressed the sentiment held by all lenders that success rested on his acumen of 'selling relationships'. He likened his interactions with the 90 percent of customers who were repeat borrowers as 'a comfortable marriage . . . very much a partnership'. It took new customers a while 'to get into the habit' of borrowing and repaying since 'maybe they're not used to that'. Establishing a 'strong rapport' was therefore crucial if borrowers were to feel that 'they don't want to let me down' (Banks and Marston 2015).

From a borrower perspective, a significant percentage of respondents (23%) took out new loans to partly finance repayments of current loans – what we termed 'spiralling' (Banks et al. 2012). A quarter of respondents also took out two or more loans concurrently – a practice we called 'paralleling'. There is no robust data on whether these types of borrowing patterns have increased or decreased in the post-2013 regulatory environment. We broadly support policies that protect the vulnerable in society – including prohibiting these borrowing patterns when it is clearly shown that business practices are engineered to take advantage of vulnerable members of our community. Our 2012 research showed that a significant proportion of respondents talked of how their lives had been made worse by being caught up in multiple borrowing practices (Banks et al. 2012).

Repeat borrowing of loans (one at a time), however, is intrinsic to both the supply and demand sides of this element of the Alternative Financial Services market. In a sense, borrowers use SACCs in a somewhat similar way that other consumers (who are not engaged in the secondary labour markets or who are not unemployed) tend to use credit cards. Until the more fundamental structural factors driving the demand for SACCs and other AFS products are addressed there is a supportable argument that consumer protections for low-income or precariously employed citizens need to be stronger than for higher-income consumers or those in steady work. If viewed through the lens of credit card protections, a higher bar could be that SACC consumers need to 'zero out' their loans before taking out another. The current regulations, if enforced, appear to meet such a criterion.

Question 6: Ban on short term credit contracts

Further research needs to conducted to understand if a single repayment, rather than two repayments, increases the risk of financial hardship for a short term loan of less than 2 fortnights. From evidence we have gathered to date, the option of one or two repayments should be available for these very short-term periods.

Question 7: Warnings

Pilot research is currently being conducted by RMIT, in collaboration with Deloittes, the Consumer Action Law Centre, Victorian Legal Aid and MoneyHelp, for a more comprehensive and user-friendly online money management tool than is currently available on ASIC's Money Smart website.

If this concept is developed, a link to this tool on SACC-provider websites is likely to prove useful. Market research into the word 'Warning' on consumer credit sites is needed to investigate its effectiveness and whether its impact decreases over time. A more positive or specific message, that is regularly updated, could be trialed. Research may find that a more effective message may highlight alternative courses of action, such as 'Looking for a cheaper loan?' to direct consumers to a NILS site or 'Free way to sort your finances' etc

Question 8: Caps on costs

Without more detailed data it is unclear whether any proposal to lower the cap on costs would make the SACC industry unviable. The industry remains highly fluid as evidenced by the recent changes to key positions at two ASX-listed companies with a high exposure to SACC products (Cash Converters and Money3) and a strategic rethink by Money3 of whether to withdraw from this market.

Overall, loan periods have tended to increase under the post-2013 regulatory regime. As we note in an analysis of Credit Corp, an ASX listed provider:

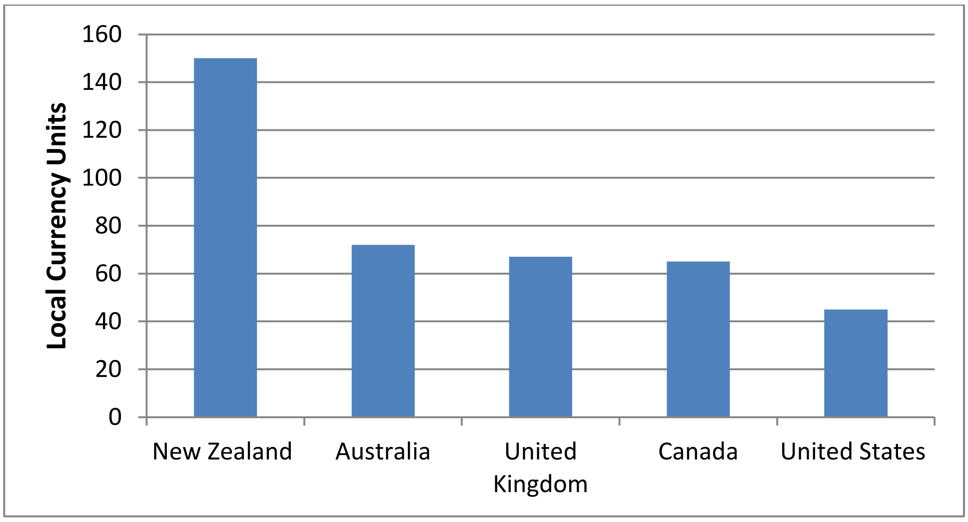
> *In 2014 the company expanded into the consumer finance sector under the Wallet Wizard brand, offering SACC, MACC and other loans up to $5,000 (Wallet Wizard 2015). While generating only 20% of total revenue ($35 million) the consumer lending business delivered 40% of the company's revenue growth in 2014 (Credit Corp 2015). Wallet Wizard is an online-only product that competes on price, charging a monthly fee of 2% rather than 4% (plus the standard 20% establishment fee). Another difference with other lenders is that Wallet Wizard sets the repayment period. For example, a $300 SACC loan requires 8 fortnightly or 17 weekly repayments (of $48 or $22.59 respectively). The table below shows the tight loan repayment windows for SACC loans (though the actual repayment period is set by the company).*

Loan Amount	Term between:	
$150 - $600	4 months	6 months
$601 - $1,200	4 months	9 months
$1,201 - $2,000	6 months	12 months

> *Increased loan repayment periods are becoming common across the sector (interviewee). It appears that Wallet Wizard is leading this trend with the average SACC loan repayment period of 8 months. Thus, while the 2% monthly fee is half the industry norm, the company's margins are increased by the longer repayment periods. For example, a typical $300 loan from Cash Converters repaid over 4 weeks costs the consumer $72 in fees and charges. In contrast a $300 loan from Wallet Wizard (set at 17 weeks or 8 fortnights) costs $84 in fees and charges.*(Banks et al. 2015a).

One way to assess the whether current caps are appropriate or too high is to compare them to similar products offered internationally. Figure 1 shows the fees and charges for taking out and repaying a AUD 300 loan over four weeks in New Zealand[4], Australia, the United Kingdom, Canada and the United States. Apart from New Zealand, these costs are fairly similar.

Figure 1 Typical repayment costs of a $300 (Local Currency Units) loan repaid over 4 weeks



Sources: (Banks et al. 2015b; CFPB 2013; FCA 2015; Justcash 2015; myCanada 2015)

[4] For a discussion why small, unsecured loans New Zealand may attract higher costs see Banks, De Silva, and Russell, 'Trends in the Australian Small Loan Market'.

International legislative changes - either recently enacted (in the UK) or mooted (in the USA) provide some further insight on whether a lower cap on costs in Australia may be viable – a market operating on smaller economies of scale. The following analysis (from Banks et al. 2015a) outlines the regulatory trends in these countries.

> ***USA***
> *In response to the GFC a national regulatory agency has also been created. The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act established the Consumer Financial Protection Bureau (CFPB) in 2011 to improve enforcement of federal consumer financial laws and expand the scope of protective legislation (Bhutta, Skiba & Tobacman 2015: 223). In March 2015 the CFPB announced that it is considering proposing new rules to end small loan 'debt traps' by requiring that lenders take steps to ensure that consumers can repay their loans and not get caught up in a cycle of repeat borrowing (CFPB 2015). The proposals cover short-term credit products that require consumers to pay back a loan in full within 45 days. Typical short-term loans include many payday loans, deposit advance products, certain open-ended lines of credit, and some vehicle title loans. The CFPB will be convening a Small Business Review Panel (at a date yet to be announced) to seek feedback on the proposals before formally proposing new rules (CFPB 2015). Importantly, the key proposals do not include a loan price cap but rather borrowing limits, new assessment requirements and tighter restrictions on various lending and borrowing practices.*
>
> *Under the CFPB's proposed new rules, lenders would first have to determine that the consumer:*
>
> - *can repay the loan when due–including interest, principal, and fees for add-on products–without defaulting or re-borrowing, and*
> - *could cover their basic living expenses while repaying loans.*
>
> *Lenders could skip these 'means testing' requirements if they instead limited each person's total borrowing to $500. The CFPB is also proposing:*
>
> - *The consumer could not have any other outstanding covered loans with any lender.*
> - *After three loans in a row, all lenders would be prohibited from making a new short-term loan to the borrower for 60 days*
> - *The consumer could not be more than 90 days in debt on covered short-term loans in a 12-monthperiod (CFPB 2015)*
>
> *For longer term loans of more than 45 days the CFPB is considering using existing lines in federal law for the coverage threshold, such as the Military Lending Act's 36% all-in annual percentage rate, which includes interest, fees, and add-on product charges (CFPB 2015).*
>
> *Industry-aligned companies have come out strongly against the CFPB's proposals. Credit reporting agency Clarity Services released a report in 2015 that found that the suggested rules would reduce the number of regulated loans by more than 70% and that monoline payday storefront businesses would cease to exist. Similarly, a report from global consulting firm Charles River Associates found that a full implementation of the new rules would have reduced the 2013 payday loan revenues of small lenders by 82% (Wheeler 2015).*

UK

On January 2nd 2015 the Financial Conduct Authority introduced new rules - most drawn from the Australian regulatory model–that extend consumer protection and compliance in the unsecured small-amount loan market, including:

- *An initial cost cap of 0.8% per day - interest and fees charged must not exceed 0.8% per day of the amount borrowed. For example, someone taking out a loan for 30 days and repaying on time will not pay more than £24 in fees and charges per £100 borrowed.*
- *A £15 cap on default fees - if borrowers default, fees must not exceed £15 but firms can continue to charge interest after default but not above the initial rate;*
- *A total cost cap of 100% - borrowers must never pay more in fees and interest than 100% of what they borrowed (FCA 2015).*
- *Individuals will only be able to roll over a loan twice before their balance becomes due*
- *Lenders limited to two failed continuous payment authority attempts, meaning they cannot keep trying to withdraw payment from consumers when the funds are not available. Instead, they must contact customers to find out about their situation and try to collect payment.*
- *Implementing a New Risk Warning and Debt Help Information link on all advertising and products (Consumer Affairs 2014).*

The regulatory changes introduced in 2015 have resulted in more than a third of payday lenders not applying for a new licence. Of 400 companies that had a payday licence only 247 have applied to the Financial Conduct Authority to continue offering small loans. The number of approved payday loans is down 70% from its peak in 2013, according to the Consumer Finance Association. Wonga, the largest lender, has posted its first losses last financial year (Dunkley 2015).

Prior to introducing the new regulations the Financial Conduct Authority estimated a number of impacts, including that:

- *11% of individuals (about 160,000 people a year) would no longer get loans.*
- *Payday lenders will lose £420m a year or 42% of their revenue (BBC News 2014)*
- *A consumer's median saving per loan would be £14*
- *The market would likely be reduced to the three largest online firms and that 'it is possible that one high-street firm may be able to operate' (FCA 2014).*

If the UK cap on costs were to be applied in Australia a $300 loan taken out over 4 weeks would attract basic fees and charges of $67.20, compared to $72 under the post-2013 regulatory regime in Australia – a not insignificant saving of $4.80 to the consumer. However, for longer periods and higher amounts, the Australian caps generate lower costs for the consumer. For example, a $600 loan repaid over 16 weeks would cost a British consumer $537.60 in fees and charges compared to $216.00 for an Australian consumer.

Further research needs to be undertaken to examine whether increased economies of scale in firms offering SACC products would provide sufficient revenue to operate if caps were lower than currently exist.

Question 9: Protection for Centrelink customers

There is insufficient evidence to respond to this question.

However, the recommendations made in the 'Caught Short' report to lower the risks of financial hardship experienced by Centrelink Income Support recipients and pensioners taking out SACC-type loans remain pertinent (see Section 7.4 'Practical steps' in Banks et al. 2012).

These include:

- Increasing Centrelink payments
- Changing payment frequency from fortnightly to weekly
- Increasing the flexibility of Centrelink Advance Payment amounts and repayment periods
- Mandating that banks who notify customers of a dishonour fee (due to a non-payment of a direct debit to SACC-type loan provider) that they can switch to a dishonour fee-free account.

Question 10: National database

As discussed in our response to the Question 1, a clear appraisal of the Australian consumer credit industry that focuses on low-income and precariously employed citizens (broadly defined as firms operating in the Alternative Financial Services market) is severely hampered by the lack of specific industry-wide datasets detailing, for example:

- Products offered by firms in the market and platforms used (online only, mixed, storefront)
- Customer segments targeted -wage earners only, Centrelink recipients etc
- The number, value and duration of loan/rental/pawnbroking contracts written or revenue received
- Customer profiles and borrowing frequencies
- Consumer practices in the mixed economy of credit
- Firm connectivities between industries in the market
- Each industry's employment levels, geographical reach, underwriting partners, risk profiles etc

While we are unclear what regulatory and legislative constraints apply to developing a broad-based and comprehensive database, ideally it would capture (in real time) transactions and other metrics mentioned above that occur across the whole AFS market, not just the SACC/MACC market. Given the low-margins operating in SACC and possibly other markets, fees charged to access and upload data would need to be very low, if it were made mandatory for firms to use this database for all contracts. It is beyond the scope of our field to recommend how such a database could be developed or what privacy provisions should apply.

However, it is noteworthy that some African countries with significant small loan markets are at the leading edge of technological innovation. It appears that South Africa and Uganda are the only two nations in the world that have comprehensive databases of consumer borrowing frequencies and amounts. The small loans industry in Uganda, for example, have responded to low literacy levels–and bypassed standard customer identification procedures in developed countries–by introducing retina- and palm-scanning technology that is then aggregated into a national database.

Question 11: Additional provisions for SACCs

We have insufficient knowledge or evidence to comment on this section.

Question 12: Anti-avoidance provisions

We have insufficient knowledge or evidence to comment on this section.

Question 13: Documentation of suitability assessments

We have insufficient knowledge or evidence to comment on this section.

Question 14: Comparable consumer leases

One way of understanding the relative affordability of a SACC loan is to compare the fortnightly cost of this form of credit to alternatives. How do SACCs compare to other credit options on a fortnightly basis? We use an example from a recent paper (Banks et al. 2015a) of a low-income parent who needs to replace her refrigerator

> *Aisha is a single parent with one dependent child who is solely reliant on Centrelink payments. Included in these fortnightly payments are Newstart Allowance at the dependent child rate ($561) and Family Tax Benefit Part A ($177)*[5]*. The motor on her refrigerator burnt out this morning and she urgently needs a new fridge before her frozen food perishes.*
>
> *As she has no savings a number of credit and financing options are explored. A search on a major consumer lease website uncovers that a Westinghouse 420 litre FF Top Mount Fridge can be rented for $28 per fortnight with free delivery on a 48 month lease (excluding fees, charges and insurance).*[6]
>
> *Aisha goes to ASIC's MoneySmart website*[7] *and uses the 'Rent vs buy' calculator to discover that the total cost to rent this fridge would be $2912. She finds that the fridge*

[5] Australian Government, Department of Human Services, '*A guide to Australian Government payments 20 March - 30 June 2015'* available at http://www.humanservices.gov.au/corporate/publications-and-resources/a-guide-to-australian-government-payments
[6] As advertised on 24/6/15 at: https://www.radio-rentals.com.au/kitchen/refrigerators.
[7] https://www.moneysmart.gov.au/tools-and-resources/calculators-and-apps/rent-vs-buy-calculator

can be purchased through an online retailer for $929–less than a third the total costs of the consumer lease.[8]

Aisha has a poor credit history and does not have a credit card that could potentially be used to purchase this product outright. She confronts a similar barrier with entering into a 48 month interest free plan to purchase this fridge from a major retailer as this would also require that she use a credit card provided by the retailer to make repayments.[9]

Aisha has three remaining options.

Taking out the maximum allowable Centrelink advance payments from her Newstart Allowance ($500) and Family Tax Benefit ($400) would cover most of the fridge costs. However, Aisha would need to forgo about $70 a fortnight from her Centrelink payments for the next six months–which she considers unaffordable.

The fortnightly costs of a two year NILS loan ($18) is by far the cheapest option. However Aisha considers that the process of applying and waiting a week or more for a decision is too long.

Finally, Aisha discovers that a 12 month SACC loan would cost her $60 a fortnight.

Aisha is very tempted simply to rent the fridge at $28 per fortnight but realizes that she is committing herself to an expensive four year contract that does not even guarantee she will own the fridge at the end of this period. She finally opts for the payday loan because she can get the fridge the next day, the fortnightly costs are $10 cheaper than getting cash through the Centrelink advances–especially since she does not have the extra $29 at hand to cover the purchase price of the fridge.

As this example shows, on a fortnightly basis, the NILS loan ($18) seems the obvious option, followed by renting the fridge ($28), a 12 month SACC ($60) and lastly a Centrelink Advance ($70). On a total cost basis, leasing is by far the most expensive option ($2912), followed by the SACC ($1560) and then the two no-interest options of NILS and a Centrelink Advance ($929). As we illustrated in Table 1 these options are **not** perfect substitutes for each other. The following excerpts from (Banks et al. 2015a) describe their key differences.

NILS products are a cheaper alternative than a commercial small loan, but do not meet three of the four dimensions that attract consumers to commercial small loans: cash is not provided as the loan is tied to a product or service; the loan process is complicated and slow; and applicants often perceive that the welfare aspects of the application process may expose them to a higher emotional cost than commercial loan procedures.

[8] As advertised on 24/6/15 at: http://www.appliancesonline.com.au/top-mount-fridges/?f_426604=Westinghouse

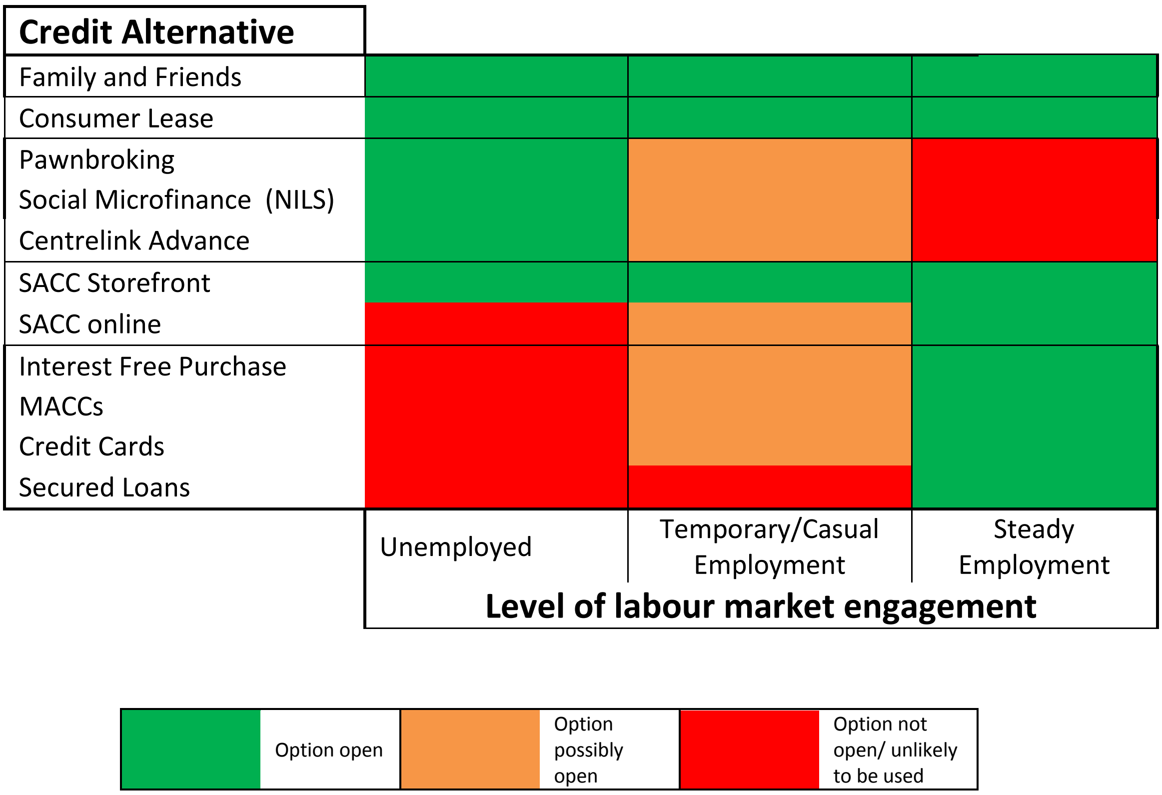
[9] For example, see Harvey Norman Interest free options available on 24/6/15 at: http://www.harveynorman.com.au/customer-service/finance-options/interest-free

Centrelink Advances have a number of features that make them highly substitutable to commercial small loans: they come in the form of cash; they are readily and speedily accessed; repayment amounts and periods are fairly clearly defined; and there is rarely a need to explain to Centrelink staff why the advance is required. One limit is the low amount available for a person receiving an allowance or with no dependent children. Another limit for higher advance amounts is that the standard Centrelink Advance recovery period of six months may make the fortnightly reduction of Centrelink payments quite large–especially in comparison to the longer repayment options of NILS loans and some other credit alternatives.

Consumer leases…have limited substitutability to SACC loans in a number of dimensions: consumer leases are not cash; access to a product, however, is fast and exposes the consumer to low emotional costs; the repayment periods are fairly clearly defined, however the end date is less clear - especially the complicated options offered by many consumer lessors to retain customer obligations. The total costs of renting a product through a consumer lease can be four or more times its retail value. However, on a fortnightly basis, rental costs are often more affordable than repayments of a six-month Centrelink advance or short-term small loan to purchase the same item

Overall, the credit alternatives in the AFS market can also be illustrated by the interaction of consumers who are unemployed, casually employed or have regular employment (Table 3). The options available for a consumer are highly conditioned on their level of labour market engagement.

Table 3 Alternative Financial Services credit options by labour market engagement



There are several important features of the AFS market indicated in Table 3. The market comprises a number of distinct credit options, this is particularly evident when the information in table 1 is also taken into consideration. In addition some options, such as online credit is typically only available to individuals in some sort of employment.

Whilst Tables 1 and 3 provide insight into the AFS market and an indication of how consumers interact with it, it is clear that the information is limited. For example:

- Are pawning items really an option for the unemployed?
- To what extent does Consumer Leasing enable poorer households access household goods?
- Assuming the costs of consumer leases are more expensive (in terms of total costs), why are they so popular?

These questions demonstrate that a considerable more information is required if effective policy is to be implemented.

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

The Australian consumer lease market is estimated to have an average annual growth rate of 3.6% in the last five years. There appears to be a growing demand by low-income households, and some other consumers, to lease domestic appliances and other household products (IBISWorld 2014a).

Similar to the SACC market, research of the Australian consumer leasing sector has been affected by the lack of an industry-wide dataset specifying, for example, the number and duration of lease contracts written, revenue received, customer profiles, the type and number of products a consumer may lease, and the sector's employment levels. An IBISWorld Report estimates that the industry had revenues of $570 million in 2014, generating profits of $126 million. With nearly 500 business offering domestic product leasing services, industry concentration is quite low The Thorn Group (19.4%) and Mr Rental (13.2%) have the largest shares of this diverse and complex market (IBISWorld 2014b).

In our research of Australian consumer leases, which includes providing market survey data to ASIC (2015), we found that:

- on a *fortnightly cost basis*, consumer leases are one of the more affordable forms of household goods access for low-income consumers; however,
- on a *total cost basis*, consumer leases are the most expensive form of household goods access for poor households.

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

Capping the costs of consumer leases while ensuring the industry remains viable requires an understanding of the sector's costs.

The model used by Nick Bienkowski and Kevin Davis (1997) in their paper on the Victorian pawnbroking industry describes the factors that would need to be considered in assessing the costs incurred in the consumer lease sector. To calculate a consumer lessor's income per month, a simple model would make some assumptions about costs, which primarily consist of employee wages, rental, interest expense/foregone on funds advanced, storage of goods, pick-up and delivery, and other costs such as advertising, licensing, insurance etc. Income derived from maximising the return on the value of a household good through varying leasing times, leveraging repeat leasing, expanding the rental commitments of customers to additional household items, and linking customers to other Alternative Financial Service credit products would also need to be factored in.

No public research has been conducted on these factors and so, again, we are hesitant to suggest what consumer protection measure should be introduced in this industry until there is evidence of the effects of caps on the sector.

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