



# The Salvation Army

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## Australia

### The Salvation Army Australia

*Submission made on behalf of The Salvation Army Australia Eastern Territory and The Salvation Army Southern Territory*

*Response to the*

**Review of the small amount credit contract laws**

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

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National Secretary

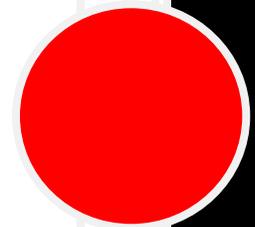
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## INTRODUCTION

The Salvation Army is one of the largest providers of financial counselling and capability services in Australia. The Salvation Army's Moneycare program has been operating for over twenty five years. Moneycare provides financial counselling, financial capability services, financial literacy services and a no interest loans (NILS) program to thousands of vulnerable people each year who experience financial difficulties.

The Salvation Army also provides extensive Emergency Relief (ER) through our community centres across Australia. The Salvation Army's ER services deliver approximately 350,000 episodes of ER assistance annually and are often the first point of contact for people experiencing multiple forms of financial and personal crisis.

The high demand of these services highlights the importance of improving access to affordable finance for these vulnerable Australians, and is a critical step to assisting our clients to build personal resilience.

Due to the very nature of the majority of clients who may access "small amount credit", the current protections within The Credit Act to safeguard the position of vulnerable Australians need to be retained and strengthened.

The Salvation Army welcomes the opportunity to comment on the Australian Government's review of the small amount credit contracts (SACC) laws and related provisions in the *National Consumer Credit Protection Act 2009* (Credit Act). This submission is informed by The Salvation Army's collective experience, knowledge and understanding in working with vulnerable and disadvantaged people who are at risk of financial hardship as a result of small amount credit contracts.

### Question 1: Competing objectives

The Salvation Army place the need to protect consumers as the central objective of the regulation of small amount credit contracts. These people are predominantly vulnerable and marginalised Australians who are excluded from mainstream credit products. As such their very vulnerability makes them "easy" targets for predatory lenders.

Consumers seeking SACCs are often unaware of viable alternatives. As is referred to in the consultation paper SACCs are generally used by low and middle income consumers. Up to 25 percent of those borrowers have incomes below the Henderson Poverty Line.<sup>1</sup> The Salvation Army's experience has been that the use of SACCs can actually exacerbate hardship, not alleviate it. This is a short term benefit that can support a person through a week. Due to the high cost of the credit, greater long term financial hardship will ensue.

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<sup>1</sup> Poverty Lines: Australia March quarter 2015. Melbourne Institute of Applied Economic and Social Research. Available at <https://melbourneinstitute.com/downloads/publications/Poverty%20Lines/Poverty%20lines%20Australia%20March%202015.pdf>

While understanding the need for a balanced approach, it must be acknowledged that SACCs providers are conducting a commercial activity - one that is increasing in size and scope. The Salvation Army supports realistic expectations of profit margins that are not at the expense of increasing the debt burden of already vulnerable Australians.

### **Recommendation**

The Salvation Army believes that a higher level of protection for consumers is necessary and therefore recommends increasing the regulatory obligations in relation to SACC's (with effective sanctions for breaches). The Salvation Army has observed many cases under the current regulatory framework where consumers have not been adequately protected and in fact find themselves in greater hardship because of the provision of a SACC. The Credit Act - Regulatory Framework (obligations) and Sanctions for breaching the regulations and obligations are the only line of defence for vulnerable Australians.

### **Question 2: Complexity**

The Salvation Army understands that research undertaken to date highlights that the current regulatory framework is having a positive impact on improving performance of SACCs. This is the mechanism whereby there is transparency within the sector and the associated reporting provides the ability for a consumer voice to be part of the analysis. A number of steps can be taken to provide consumers with a higher level of protection. These will be referred to later in this submission. Our aim is not to increase regulatory burden. The Salvation Army is happy to work with industry to ensure that vulnerable people are not caused further hardship.

### **Recommendation**

The Salvation Army recommends continuation of the current Regulatory Framework (with appropriate sanctions) as this is imperative to protect consumers.

### **Question 3: Sanctions**

The Salvation Army supports the current regulatory structure wherein The Credit Act imposes sanctions. Furthermore, The Salvation Army applauds ASIC for the material on the MoneySmart website. ASIC have done some very good work in regard to civil sanctions for SACC providers and by highlighting the dangers of SACCs more generally. Although, by definition these are small loan amounts, they are very material amounts in regard to a low income person, and overall the volume in the industry is very high. So large amounts of money can be made available by providers, and material amounts of debt taken on by consumers. ASIC reports and reports by various community agencies have repeatedly shown the harm caused by inappropriate SACCs.

### **Recommendation**

In view of this The Salvation Army believes that there needs to be additional deterrents for credit providers. Furthermore, The Salvation Army believes the maximum penalties are insufficient and recommends they be increased by 50 percent to provide a more substantial

deterrent.

The Salvation Army also recommends the following enhancements:

- comprehensive data capture on the extent of breaches and the sanctions imposed
- public reporting of all SACC's breaches of The Credit Act . To increase transparency in this sector we recommend initiation of a public access ranking of SACC's providers based on the number of breaches and sanctions imposed. This strategy is founded on the more recent practice of reviews of current practice made public through initiatives such as - "Rank the Banks" and "Rank the Energy Providers". These public reports have been credited with being a very effective tool in reforming current practice to build in increased protections for consumers
- extension of The Credit Act regulatory framework and sanctions that apply to SACC's to also apply to all Consumer Leases (where there are currently "no caps").

#### **Question 4: Obligation to obtain and consider bank account statements**

It has been The Salvation Army's experience in operating a no interest loans program (NILS) that bank statements are an invaluable tool when working with clients to properly understand their financial position and most importantly, their capacity to repay a loan without hardship. The Salvation Army's NILS program has been operating for over five years and has provided over \$1.5 million in loans to low- income people who could not otherwise access safe and affordable credit.

Bank statements are essential to determining capacity to repay. They are used in a conversation with the client to prepare a reliable budget and statement of financial position. They help to jog the recollection of a client, describe the financial history of a client and can lead to useful money conversations.

As evidenced in the consultation paper, SACC providers seem to be complying with obtaining bank statements however the concern is over the use, or non-use of them. The Salvation Army believes that if bank statements are used in an effective manner this will ensure that only those who can afford repayments would be provided with a loan. No doubt this would also help reduce arrears and costs for SACC providers.

The preparation of a realistic budget and statement of financial position is critical to properly assess a person's eligibility for a loan of any kind. This should not be done in a cursory manner.

#### **Recommendation**

The Salvation Army recommends that it be made clear in all relevant documentation that bank statements are confidential documents that form part of the assessment of the loan request. Due to the confidential nature of these documents (linked to privacy legislation) SACC's providers cannot use this information for marketing purposes.

The Salvation Army recommends that staff of SACC providers be trained in basic financial literacy and budget preparation. There are three financial literacy units within the

Community Services Certificate III course which would be of assistance in this regard. Other financial service sectors have minimum qualifications; this sector should be no exception.

### **Question 5: Restrictions on repeat borrowing**

The Salvation Army supports the 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 SACC, as well as the need for retention of both of these benchmarks. The likely cost savings of requiring SACC providers to use both of these existing benchmarks from a SACC's perspective would be a potential reduction in loan defaults. The cost saving from the perspective of The Salvation Army is an "intervention" that may reduce the damaging impact on individuals of an ever expanding debt spiral through repeat borrowing.

The comprehensive credit reporting (CCR) regime now in place should provide sufficient information for a SACC provider to make a decision on these matters.

#### **Recommendation**

The Salvation Army does not advocate for the use of other benchmarks in assessing a person's capacity to repay or if the loan is not unsuitable. We believe that after considering the aforementioned benchmarks each application should be considered in full on its own merits, as circumstances vary from person to person.

### **Question 6: Ban on short term credit contracts**

The Salvation Army believes that practices identified in ASIC's Report 426 where "some lenders are entering into SACC's which require repayment by a single payment". Although this is not a breach as such, it is a potential "work around" the 15 days or less prohibition. This may benefit from being investigated further with a view to development of controls that better reflect the "intention" of The Credit Act.

#### **Recommendation**

The Salvation Army recommends that the prohibition of loans with a term of 15 days or less remains within The Credit Act.

### **Question 7: Warnings**

The Salvation Army strongly endorses the embedded requirement for SACC providers to provide a specific warning statement to consumers. Provision of information of alternatives to consumers is very important. The Salvation Army strongly believes that in many cases there are more effective and safer alternatives to SACCs. Whilst the current warning notice rightly refers to financial counsellors, utility providers, Centrelink and the MoneySmart website, the no interest loans program should also be referred to.

## **Recommendation**

The Salvation Army recommends that warning statements are mandated to appear at the beginning of websites and documentation (not at the bottom where a consumer needs to “scroll down” in order to see). Additionally, the colour and font of warnings should be standardised and a style guide outlining the prescribed text be issued to SACC’s to mandate exactly how warnings are to be displayed. Warnings must be a “stand alone” statement that cannot be blended into other text. Websites must be designed to ensure that “pop-up” boxes cannot obscure the mandated warnings.

To achieve this The Salvation Army is aware of effective programs to redesign materials to make them more readily understandable and actionable e.g. NSW state debt recovery office notices. We further recommend that behavioural psychologists with experience in this area, be consulted in this regard.

## **Question 8: Caps on costs**

The Salvation Army maintains that monthly fees of 4 percent and initial fees of 20 percent of the credit amount are excessive. Prior to the national SACC laws, the NSW cap of 48 percent overall allowed a substantial industry of SACC providers to conduct business, and this was in an environment of generally higher interest rates.

## **Recommendation**

The Salvation Army recommends that monthly fees be capped at 3.8 percent and the initial fee be capped at 2 percent of the credit amount. This would provide a reasonable business case for SACC providers and interest rates for consumers closer to other mainstream commercial rates.

The Salvation Army strongly supports the retention of “Caps” that protect clients and ensure that the lending reflects mainstream practice. The Salvation Army recommends that a review framework be implemented to monitor the impact of caps from both a consumer and industry perspective.

## **Question 9: Protection for Centrelink customers**

The Salvation Army does not believe the current cap for people on Centrelink payments is an effective protection. Twenty percent of income for the repayment of one type of debt, in this case a small loan, is really very unrealistic. People are considered to be in housing stress when housing costs exceed 30 percent of income, so when one type of debt can be up to 20 percent of income the system is inherently problematic.

It is The Salvation Army’s experience that most clients with Centrelink as their primary source of income need to spend most of their income on necessary living expenditure (e.g. rent, food, clothing, utilities, transport, etc.). Little is left over for any sort of repayments.

The Salvation Army conducts an annual economic and social impact survey, ESIS report. (<http://salvos.org.au/about-us/latest-news/media-newsroom/20150527-2015-esis-report/>)

The May 2015 report, based on 2,406 responses from clients accessing ER found that; people paid 59 percent of their income on accommodation costs and had \$125 per week to live on after accommodation expenses. Additionally, 75 percent of respondents indicated they had cut down on basic necessities, 59 percent had either delayed or were unable to pay utility bills and 57 percent had gone without meals.

### **Recommendation**

The Salvation Army recommends that 5 percent of income would be a more realistic level and be more likely to provide reasonable protection for vulnerable consumers. Other groups of people with incomes similar to Centrelink benefit amounts should be similarly protected.

### **Question 10: National database**

The Salvation Army believes that there is sufficient information currently available to properly assess a person's financial situation and capacity to repay a SACC. In addition to the comprehensive credit reporting (CCR) regime, basic documentation such as bank statements, Centrelink income statements, pay slips, debt statements, rental statements and utility accounts can, when properly used provide relevant information on a person's situation.

The Salvation Army's concerns in relation to the establishment of a National Database to capture client activity for review by SACC providers relates to protection of clients from a privacy perspective, the accuracy of actual listings and the ability for data held in this database to be amended.

The topic of introduction of a National database has previously been the subject of a separate ASIC consultation (ASIC Consultation Paper 198 – Review of the effectiveness of an online database for small amount lenders). The Salvation Army found the response to this submission developed by the Consumer Action Law Centre in Melbourne and Consumer Law Centre of ACT to be very considered responses. Both papers mirror the concerns of The Salvation Army in relation to the privacy concerns in relation to the proposal.

Furthermore, these submissions detail the benefits of SACC providers using a database to check if prospective SACC loan applicants may already have existing loans and/or be in default. However, for a database to be effective it must have prescriptive "mandatory" compliance regulations for SACC providers. It must have a compulsory client registration and compulsory application approval function, prior to proceeding to approve a client's application.

### **Recommendation**

The Salvation Army believes the CCR database is more than sufficient along with the above mentioned documentation. Further that in place of introduction of a new database that

investigation be undertaken into adding enhancements to the existing credit reporting system to capture of data required and that SACC's providers would then be required to use this system to both check client history of existing loans as part of the assessment process and to record client loan approvals.

### **Recommendation**

The Salvation Army believes the CCR database is more than sufficient along with the above mentioned documentation.

### **Question 11: Additional provisions for SACCs and**

### **Question 12: Anti-avoidance provisions**

The Salvation Army is aware that consultation was undertaken in 2012 on a general anti-avoidance provision within the exposure draft of the National Consumer Credit Protection Amendment (Credit Reform Phase 2 Bill 2012) but this bill was not enacted.

### **Recommendation**

The Salvation Army recommends that the content of this bill be revisited as a means to progress the introduction of appropriate anti-avoidance provisions within The Credit Act.

### **Question 13: Documentation of suitability assessments**

As referred to in Question 3, a requirement to document the process would assist in the enforceability of provisions. If the process was not adequately documented, that could be an offence in itself (e.g. not keep proper records). This sort of provision would ensure that an assessment was completed and provide a basis for review.

### **Recommendation**

The Salvation Army recommends a simple but clear process to document what assessment has been undertaken, aligned to SACC regulations that verify why an assessment has deemed the application to be suitable or not suitable for SACCs loan. This could also assist SACC providers as a checklist to ensure that relevant matters were addressed and would provide guidance to the sector.

### **Question 14: Comparable consumer leases**

In our experience clients observed very little or no difference between pay day loans and consumer leases. Both are essentially a means to acquire funds or an asset, usually at a time of urgency or need, when no other options exist.

All leases, where the particular leased item is less than \$2,000 should be considered comparable to SACCs. If multiple goods are leased each should be considered individually.

Clearly, there should be greater consistency in the regulatory requirements for SACC and consumer leases. Both products have the potential to cause vulnerable people further hardship and reasonable protections should be put in place.

The discussion paper records cases of exorbitant interest rates (of 248% and 884%) occurring in the unregulated consumer lease sector. The Salvation Army can report that this accords with the stories of vulnerable clients attending its services significantly increasing financial hardship.

### **Recommendation**

The Salvation Army strongly recommends that consideration be given to bringing consumer leases that currently fall under Part 11 of the Credit Code into line with exactly the same Regulatory Framework that applies to SACCs.

### **Question 15: Applying SACC provisions to comparable consumer leases**

There are additional particular requirements for leased goods however issues outlined above are all valid for inclusion. As referred to in question 7 above, the form and content of disclosure is critical and further advice from experts should be sought.

### **Recommendation**

The Salvation Army recommends that similar provisions should apply and that all consumer leases including those that currently come under Part 11 of the Credit Code should be a part of the SACC regime.

### **Question 16: Cap on costs for consumer leases**

The Salvation Army strongly supports the introduction of a cap on consumer leases that is comparable to SACCs.

### **Recommendation**

The Salvation Army recommends the establishment of a working group to consider what cap structure would best meet the needs of all stakeholders and provide the best protections for vulnerable Australians.

## CASE STUDIES

The following case studies demonstrate the effectiveness of community based no interest loans and the dangers of consumer leases.

### Cast Study 1

[Client] is a young woman living in country NSW, who lives alone as her partner is currently in gaol. Her main income is Centrelink Youth Allowance. She does not have a bed and is sleeping on a mattress on the floor. She does not have a washing machine. She does some part-time work, runs a car and provides some financial support to her partner in jail. She is studying an online diploma in real estate and, adding to her financial burden, she rents a laptop computer for her studies at \$50 per month from a goods rental company. As she did not know about NILS when she entered the rental agreement a NILS loan could have saved her additional costs and freed up her budget for other necessities. Her budget is tight but her ability to pay the rental lease costs indicates that she can afford the NILS loan repayment. Client was offered a NILS loan and successfully completed her studies.

### Case Study 2

[Client] is a single mother of five children. She is studying at TAFE and sought a NILS loan for a computer for herself and her high school age children. In reviewing her financial position it was discovered that she had leased a smart phone from a local appliance rental company, repayments were \$63 per fortnight over 52 payments for a total cost of \$3,276. A search of similar products indicated that the same device could be purchased outright for around \$600. This is a large financial obligation and she could have well done without this burden. To assist her, a NILS loan was approved for the computer.