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SACC Review Secretariat
Financial System and Services Division
Markets Group
The Treasury
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Dear Panel Members

Review of the Small Amount Credit Contract Laws – Interim Report December 2015

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the *Review of the small amount credit contract laws—Interim report December 2015* (**Interim Report**).

We support the acknowledgment in the Interim Report that small amount credit contracts (**SACCs**) are causing financial harm to consumers, and are leading to increased levels of financial exclusion. We concur with the observation that the structure of the existing SACC cap promotes repeat borrowing, and that existing measures are ineffective in preventing irresponsible lending, which leads to consumer debt spirals. We also concur that competition in the SACC market is not operating to reduce the cost of credit, and that cost will only reduce with clear and effective regulation.

However, we do not agree that a concession from the 48 per cent cap on consumer credit remains relevant for SACCs. In our view, a 48 per cent cap remains the preferable regulatory response and should be considered along with the other options identified in the Interim Report. The exclusion for SACCs from the 48 per cent interest rate cap is predicated on administrative costs associated SACCs, and with increasingly automated, online lending models, the administrative cost of providing SACCs is falling. This warrants a re-examination of the 48 per cent option. Moreover, a robust price cap on payday loans has been shown internationally to be the most effective policy intervention to prevent repeat borrowing, and the consequent risks of a debt spiral and ongoing cycle of disadvantage.

Despite our preference for a consistent 48 per cent cost cap, we have provided our comments on the options that have been identified by the Interim Report, and believe they do represent a positive step forward in dealing with the harm caused by SACCs. We concur with the policy intent that if SACCs are to be used, they should only be used as an emergency source of funding for one-off

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expenses, and regulation should be stringently designed to assist consumers in discharging their SACC debt without being caught in an ongoing debt spiral.

In relation to consumer leases, we support the acknowledgment in the Interim Report that consumer leases are causing significant harm, and ought to be regulated consistently with other forms of consumer credit under the Credit Act. While we have provided comment on the regulatory options raised in the Interim Report, we remain of the view that the 48 per cent cap should also be considered for consumer leases, based on the cash price of the goods. This cap should include the cost of add-on features and products associated with the lease, with the possible exception of delivery charges—which should be subject their own, separate cap. The Interim Report correctly identifies that such "add-ons" currently represent a large proportion of the costs of consumer leases, and lack transparency. In our view, such products also lack value.

Our comments are detailed more fully below.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action offers free legal advice, pursues consumer litigation and provides financial counselling to vulnerable and disadvantaged consumers across Victoria. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

Responsible lending obligations for SACCs

Consumer Action concurs with the Interim Report's conclusion that existing consumer protections do not appear sufficient to prevent to prevent significant financial harm to consumers who use SACCs. Repeat borrowing remains prevalent despite existing measures to prevent this behavior, and the rebuttable presumptions designed to enforce responsible lending appear to have failed.

Consumer Action also concurs with the Interim Report's observation that regulation of the financial sector should be geared towards facilitating financial inclusion, and minimizing financial exclusion. Although we stress that when we use the term "financial exclusion" we mean more than simply access to credit, and take the broader view, articulated by the Brotherhood of St Laurence (amongst others):

> "[*financial exclusion is*] *a process whereby a person lacks or is denied access to affordable, appropriate and fair financial products and services, with the result that their ability to participate fully in social and economic activities is reduced, financial hardship is increased, and poverty (measured by income, debt, and assets) is exacerbated*."[1]

On the above construction it is entirely possible for a consumer to have access to mainstream financial services, yet still be at risk of resorting to payday lending and experiencing financial exclusion as a result.

[1] Ingrid Burkett and Genevieve Sheehan (2009) 'From the Margins to the Mainstream: The Challenges for Microfinance in Australia', Brotherhood of St Laurence and Forresters Community Finance, page v.

Through our legal practice, Consumer Action continues to encounter clients with multiple concurrent payday loans, and significant histories of repeat borrowing. In fact, in the two weeks during which this submission was drafted, our legal practice has taken on five new cases referred by our financial counselling practice.

In one case, we are representing a single mother with a three year old child who has been dependent on Centrelink for three years, and has multiple payday loans. The client has a history of repeat borrowing, and has also borrowed from family to meet her rent—as she was facing eviction. In another case, we represent a recent immigrant with limited English language skills, and a history of gambling. When he contacted our financial counselling service, the client had five SACCs outstanding with three separate lenders, and two medium amount credit contracts ($2400 each). In another case, a forty year old client also with a history of gambling had four outstanding SACCs, (all with separate lenders), in addition to another $4000 medium amount credit contract. The client was overdrawn on his bank account, lived with his family and had a fortnightly income of $1,750.

The following week we took on a case for a single mother of two children, dependent on Centrelink income who had been repeat borrowing every six weeks, and had in her estimation "well over a dozen" such loans, which in her words she had "been using like a credit card". We also took on a case representing two brothers, both recent immigrants and both with poor English language skills. The brothers are living in public housing and dependent on Newstart payments. Both have borrowed repeatedly from two separate lenders. The first brother appears to have taken twenty one loans from Money3, and three loans from Cash Converters in the three years that he has been in Australia. The other brother, (who has only been in Australia for approximately two years), appears to have taken thirteen loans with Money3 and eleven with Cash Converters.

We stress that these cases by no means represent all the clients who present to our financial counselling service with SACC related financial hardship—these are just the matters that have been referred onto our legal practice, for further representation. All matters illustrate that the rebuttable presumption model of consumer protection has failed (loans have been written which were clearly "unsuitable"), and that repeat borrowing, and concurrent SACCs from multiple lenders remain prevalent. All but one of the above clients is dependent on Centrelink benefits, two have gambling issues, and three are recent immigrants with limited English language skills.

Our own case experience is supported by multiple sources of statistics confirming that the industry is growing significantly, and much of this growth is built on unsustainable borrowing by vulnerable consumers. The explosive growth of online lending models,[2] in particular, gives rise to the potential for significant economic and social harm if stronger measures are not taken as a matter of urgency. On current predictions (and in terms of the value of loans written per year) the payday loan industry is likely to grow from a $670,000 in 2015 to $1 billion by 2018, and the vast bulk of that growth will be generated through lending to low-income and vulnerable consumers.[3]

[2] Digital Finance Analytics and Centre for Commercial Law and Regulatory Studies at Monash University, 'The Stressed Finance Landscape Data Analysis', October 2015, p 13.
[3] Digital Finance Analytics and Centre for Commercial Law and Regulatory Studies at Monash University, 'The Stressed Finance Landscape Data Analysis', October 2015, p 26.

In Consumer Action's view, the most powerful regulatory tool available to curtail harm caused by SACCs is price control. Internationally, a robust price cap has been shown to be the most effective measure to prevent repeat borrowing, and the consequent risks of a debt spiral and ongoing cycle of disadvantage.[4] On that basis, we believe the 48 per cent cap on consumer credit warrants careful examination. With the falling cost of administration due to increased automation and online lending models, we are unconvinced that the concession applied to SACCs remains justified. A comprehensive 48 per cent cap would be the most effective mechanism to reduce financial exclusion, and the harm it causes.

<u>Repeat borrowing</u>

- ***Option 1 – Reduce the establishment fee for subsequent loans for a returning customer from 20 per cent to 10 per cent.***

Consumer Action supports Option 1. The Interim Report correctly identifies that the establishment cost of a subsequent loan for a repeat customer is lower than the cost of establishing their initial loan, and on that basis, there is no rational justification for continuing to apply the same fee. To do so is not reflective of cost.

Option 1 would also go some way to removing the incentive for lenders to encourage repeat borrowing, as they would no longer be more profitable than a consumer's initial loan with the same lender.

Further, Consumer Action notes the Review Panel's comment that "…*the rationale for granting SACC providers a concession from the 48 per cent cap breaks down for subsequent loans. At the time the caps were introduced, the concessionary treatment for SACCs was justified on the grounds that SACC providers had high upfront administrative costs.*"[5]

Consumer Action contends that with the explosive growth of online lending (from 3.1% of SACCs in 2010, to 68.8% of SACCs in 2015—with 43% of those being accessed either through a smartphone, or a publicly accessible computer[6]), administrative costs for lenders have fallen significantly in recent years, and the rationale for concessionary treatment has therefore broken down—not just in relation to subsequent loans, but also for initial loans. We would urge the Review Panel to investigate administrative cost levels for SACC providers, and to re-visit the 48 per cent cap option. If the concession can no longer be justified, then it should be removed.

An APR-based cap, such as the proposed 48 per cent cap, also provides consumers with a clearer comparison point to compare the cost of payday loans against other forms of credit. A cap based on an establishment fee plus an additional monthly rate can be unclear for consumers and is often

[4] For example, see: Montezemolo, Susanna 'The State of Lending in America and its Impact on US Households', Center for Responsible Lending (CRL) September 2013; Citizens Advice (UK) 'Payday loans problems halved since cap introduced' https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/media/press-releases/payday-loan-problems-halved-since-cap-introduced/

[5] SACC Review Panel, '*Review of the small amount credit contract laws—Interim report December 2015*' p 12-13.

[6] Digital Finance Analytics and Centre for Commercial Law and Regulatory Studies at Monash University, 'The Stressed Finance Landscape Data Analysis', October 2015, p 13.

understood incorrectly as an APR rate. This error is even made by media commentators, which only adds to adds to community confusion.[7]

Consumer Action also submits that the price model that allows for a large upfront establishment fee has driven lead generation in the industry. During the SACC Review stakeholder consultations, it became clear that lead generation is a significant income earner for some SACC providers and other intermediaries. It seems that websites, comparison services and some SACC providers (who will not approve someone for a loan) will refer consumer information to other providers who will perhaps make a loan. The second provider pays for the consumer information or 'lead' through the high upfront establishment fee. Consumer Action submits that this model creates perverse incentives and does not lead to SACC providers taking adequate care to know their customers and ensure responsible lending rules are complied with.

Consumer Action concurs with the Review Panel's assertion that Option 1 in itself would not be sufficient to deter SACC providers from encouraging repeat borrowing, and would need to be combined with either Option 2 or Option 3. Consumer Action is of the view that Options 2 and 3 are not mutually exclusive and both should be applied. We discuss this further below.

- ***Option 2 – Replace the rebuttable presumption that a SACC is unsuitable if a customer has had two or more SACCs in 90 days, with a bright line test banning the provision of SACCs to consumers who have had two or more SACCs in the past 90 days.***

Consumer Action supports the notion of a bright line test, although in our view a two loan limit in a 90 day period could be easily circumvented by loan providers simply providing loans with a 45 day repayment term. In our submission to the SACC Review Panel Discussion Paper, Consumer Action advocated for a bright line test of no more than two SACC loans per year, and we maintain the view that this is an appropriate limit.

As the Interim Report states, if SACCs are to be useful, then it is when they are used as an emergency source of funding for one-off expenses. Consideration of Option 2 should be undertaken with that policy objective in mind; it should not be able to be circumvented so that borrowers are repeatedly accessing SACCs of a slightly longer loan term. It is our view that two 'emergencies' per year is more appropriate, and likely to significantly reduce the likelihood of repeat borrowing driving a debt trap and a cycle of disadvantage.

Further, a bright line test has the benefit of simplicity and clarity, and removes the self-regulatory aspect of the rebuttable presumption—which has been shown to be ineffective. It addresses the core problems of irresponsible lending and repeat borrowing, and is relatively simple to enforce.

The available statistics,[8] and Consumer Action's own experience through our financial counselling and legal service, indicate that repeat and concurrent loans from various payday lenders also remains an issue. To address this, a comprehensive database, or register, of payday loan

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[7] For example, see: http://www.theaustralian.com.au/business/financial-services/money3-changes-course-with-focus-on-car-finance/news-story/e69c94da3b7571362a7fbe63a8e04db2

[8] For example see: Digital Finance Analytics and Centre for Commercial Law and Regulatory Studies at Monash University, 'The Stressed Finance Landscape Data Analysis', October 2015, p 8.

borrowers would need to be established. Without this the bright line test could be ineffective. We refer to our previous submission's discussion of this issue.

- ***Option 3 – Extend the protected earnings amount for Centrelink recipients, where total SACC repayments cannot exceed 20 per cent of gross income, to all consumers and lower the protected earnings amount to no more than 10 per cent of net income.***

Consumer Action supports this option, and is of the view that it would probably be a more effective reform than Option 2 above, primarily due to the practical difficulties of instituting a bright line test and the potential for regulatory arbitrage by adjusting the length of loans. That being said, the two options are by no means mutually exclusive, and given the policy intent of reducing consumer harm and promoting financial inclusion, Consumer Action is of the view that they should both be adopted.

Certainly, extending protected earnings amounts to all borrowers of SACCs and lowering that rate to 10 per cent of net income would have a positive impact on the affordability of SACCs, and improve the capacity for consumers to discharge their SACC obligations and return to healthy financial inclusion.

This option would be even more effective if the protected earnings amount was set at 5 per cent of net income. In Consumer Action's view, this still represents a significant portion of a borrower's income—more than enough to be dedicated to servicing a SACC. We note that the 5 per cent level was identified in previous submissions to the SACC Review Panel, and not only by advocates from the not-for-profit, community sector. Notably, Credit Corp identified 5 per cent as a reasonable level to set when identifying protected earnings,[9] a level that is also recommended by the Pew Trusts[10], and Consumer Financial Protection Bureau (CFPB) in the USA.[11] Given that the policy debate is trending towards 5 per cent of income, Consumer Action would urge the Review Panel to examine this level when considering protected earnings.

Alternatively, if protected earnings are to be set at 10 per cent of the borrower's net income, then there would be merit in including other credit obligations within that cap—such as consumer leases and medium amount consumer contracts. Through our case work, Consumer Action routinely assists clients who are juggling debts across all these products. Promoting financial inclusion requires addressing financial health across all credit obligations. Consumer Action notes that the Review Panel have considered this and posed the question:

- *Does the cap on repayments need to be broader than just SACC repayments? For example, should lease repayments and other fixed obligations also be included?*

Consumer Action is strongly of the view that any cap on repayments does need to be broader than just SACC repayments. Without including a range of credit and other fixed obligations, the

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[9] Credit Corp submission to the Review of Small Amount Credit Contract Laws, 15 October 2015, p 21 para 18.10.
[10] The Pew Charitable Trusts, "Payday Lending in America: Policy Solutions', October 2013, available at: http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydayoverviewandrecommendationspdf.pdf
[11] Small Business Advisory Review Panel For Potential Rulemakings for Payday, Vehicle Title, And Similar Loans, 'Outline of Proposals under consideration and alternatives considered' (Proposals Outline, Consumer Financial Protection Bureau, 26 March 2015) 20-21, 27-28 <http://files.consumerfinance.gov/f/201503_cfpb_outline-of-the-proposals-from-small-business-review-panel.pdf>.

repayment cap would be significantly less effective in addressing financial exclusion. Consumer Action is of the view that 10 per cent of net income should be the maximum of any such cap—and should serve as a default presumed level, pending definitive, credible research and modelling that justifies an advance on that figure.

Default fees

Consumer Action reiterates its view, as stated in our initial submission to the SACC Review Panel, that in many cases default fees appear to outweigh the actual costs incurred by the lender when administering consumer defaults. In our view, default fees are often used to artificially inflate profits. Given inconsistent practices in this area—and the lack of competition in the sector generally—there is a clear case for regulating default fees further. Consumer Action agrees with the view expressed by the SACC Review Panel in the Interim Report that high default fees can contribute to debt spirals and repeat borrowing, and therefore work against financial inclusion.

We also note that, in other sectors, default fees are specifically prohibited. For example, section 40C(1) of the *Electricity Industry Act 2000* (Vic), prohibits default fees stating:

> *"A term or condition in a contract for the supply or sale of electricity by a licensee to a small retail customer (whether entered into before or after the commencement of this section) is void to the extent that it permits the licensee to charge the customer a fee or charge for late payment of an electricity bill."*

This policy recognises that those who default are likely to be experiencing financial hardship and further fees only serves to exacerbate that hardship.

- ***Option 4 – Introduce a default window, where no default fees can be charged until the consumer has missed a payment by one payment cycle.***

Consumer Action supports this option. An initial "breather" would give consumers the grace they need to resolve their SACC debt and move towards financial inclusion, without slipping into repeat borrowing.

In Consumer Action's experience, most borrowers of SACCs who default are experiencing financial hardship. This experience is verified when considering the way SACCs usually operate. Most SACC providers secure repayment through the use of a direct debit authority. Defaults therefore occur primarily due to borrowers having insufficient funds in their bank accounts to make the relevant direct debit. In our experience, it is very rare of a borrower to take steps to cease a direct debit authority.

The National Credit Code has a robust policy framework around financial hardship. It requires lenders to consider applications to vary the loan if a borrower is unable to meet their obligations under the loan contract.[12] Lenders should not charge for this practice. In our view, Option 4 builds on this consumer protection, by acknowledging that the borrower who defaults on a SACC is likely to be in financial hardship and should be provided a temporary grace period or variation. While borrowers of course have the right to seek a hardship variation from a SACC provider, given the short-term nature of many SACCs and the vulnerable nature of borrowers, the seeking of such a

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[12] *National Consumer Credit Protection Act 2009 (Cth)- Schedule 1 – National Credit Code* s 72

variation may not be a reasonable expectation of borrowers. In this light, Option 4 aligns with the behavioural biases of borrowers and may ensure consumers in financial hardship are consistently protected by our credit laws.

As the Review Panel points out, Option 4 would need to be introduced in conjunction with Option 5 to be effective, otherwise the providers would increase the amount of default fees to make up for the enforced lag in being able to apply them.

- ***Option 5 – Maintain the current maximum amount recoverable for default of a SACC but introduce a supplementary cap to limit how quickly fees can be charged (for example, $10 per week).***

Consumer Action supports this option. This is a sensible reform and relates to the fact that default fees are meant to reflect the increased administrative costs of payment recovery, rather than operate as an artificial way to boost the cost of the loan (and therefore profitability). Consumer Action supports a $10 per week cap, as this sets a bright line rule, and would inhibit the various different approaches taken by SACC providers.

A supplementary cap on default fees would operate to prevent the loan cost from becoming too great a proportion of the borrower's income, and would assist them in discharging the SACC debt obligation and achieving financial inclusion.

- ***Option 6 – Cap default fees as a percentage of the amount outstanding on the SACC.***

This is not a preferable option and would require further investigation to determine an appropriate percentage amount at which to set the cap. This option would be more complex to administer than a flat supplementary cap. For that reason option 5 is preferable, particularly if there is certainty of the amount of the cap (i.e. $10 per week). .

Further, default caps are meant to recover the cost of administering defaults. We do not believe these costs vary significantly with the amount outstanding on the SACC. While there may be a time cost to money, this is likely to be a very low proportion of current default fees. For example, in relation to overdue water accounts, the Essential Services Commission sets an allowable default charge of around 6 percent per year which is to reflect the lost opportunity to the business from accessing these funds.[13] On the amount outstanding on a common SACC, this is likely to be a very small weekly amount. In the SACC market, the primary cost of defaults is customer follow up, i.e. text messages, letters, calls etc. These are likely to be fixed charges, rather than variable.

Consumer Action is also of the view that subsection 39B(1) of the National Credit Code warrants review, and that the maximum amount recoverable for a SACC (currently set at twice the adjusted credit amount, inclusive of all repayments made and other fees charged), could be reduced to one and a half times the adjusted credit amount—effectively reducing the overall limit for default fees from 100 per cent of the value of the loan, to 50 per cent.

[13] Essential Services Commission, *Final decision—Water Customer Service Codes—Debt Management Powers,* December 2012, available at: http://www.esc.vic.gov.au/Water/Water-Customer-Service-Codes-amendments-2012/Water-Customer-Service-Codes-Debt-Management-P-%281%29

In our view, this would more fairly reflect the genuine costs of default to the lender, which are dropping due to increased automation in the industry. We note a recent media report in which online SACC lender MoneyMe called for just such a reform,[14] on exactly that basis. We would support this measure as an effective reform to prevent lenders from artificially raising loan costs through the inappropriate application of default fees.

Anomalies arising from the small amount credit contracts cap

- ***Option 7 – Provide SACC consumers with a benefit for early repayment by specifying the reduction in payment that would arise from early repayment of a SACC (whether in full or in part).***

High cost loans which provide no benefit for early repayment clearly counter financial inclusion policy goals. On that basis, Consumer Action supports this option, while acknowledging that many of the low income clients we serve are unlikely to repay early.

Of the examples posited in the Interim Report, basing the 4 per cent monthly fee on a declining balance, and ensuring that monthly fees are not paid for outstanding months if the consumer pays out early are both recommended—and could be adopted as complementary measures. Of the two, basing the 4 per cent monthly fee on a declining balance is preferred as it would benefit all borrowers—whether they are able to repay early, or not. A per cent monthly fee applied to the declining balance of a SACC over the term of the loan would mean that even if the loan is not repaid early, the applicable fee for each month that the loan runs would decline—easing repayment pressure on the borrower, and reducing the potential for repeat borrowing.

That being said, Consumer Action's preferred model would be for a 48 per cent interest rate cap on SACC's (rather than a monthly fee based approach), and that interest rate should be based on a declining amount—both reducing overall cost, and giving consumers a clear incentive to pay the loan off as soon as possible.

- ***Option 8 – Require SACCs to have equal repayments over the life of the loan, while still allowing consumers the ability to pay off a SACC early.***

Consumer Action strongly supports this option, and agrees with the Review Panel's analysis that the practice of two-tier repayment amounts, or "fee-splitting", increases the risk of repeat borrowing. The practice effectively front-loads the cost of the loan, allowing the lender to quickly recoup their capital, but putting the borrower under undue pressure in the process.

Consumer Action serves numerous clients through both our financial counselling and legal practices who are repaying SACCs structured in this manner, and experiencing financial difficulty as a result. We raised this issue in our initial submission, and reiterate our observation there that according to the Pew Trust, it is important to prevent front-loading of fees as:

> '*experience shows that front-loading practices make the early months of the loan disproportionately more profitable for lenders than the later months, creating incentives for*

[14] http://www.smh.com.au/business/banking-and-finance/payday-lender-moneyme-calls-for-tougher-rules-20160111-gm36j0.html

them to maximise profit by encouraging borrowers to refinance loans before they are fully paid off.'[15]

The following case study, also drawn from our previous submission, highlights the issue.

Phillip's story
Phillip works full time and his household had recently gone from a double to single income. Phillip, his partner and child live in rental accommodation. Phillip contacted MoneyHelp (Consumer Action's financial counselling service) as he and his partner were struggling to pay the bills and were negotiating hardship arrangements with one of his creditors. Phillip had been provided with two payday loans, one of which was a $2000 loan for a term of 12 months. Phillip's repayments under the $2,000 loan contract were nearly $100 per week for the first 26 weeks of the contract, and less than $35 for the remaining 26 weeks. It did not appear that this step down in payments met Phillip's requirements and objectives—instead, it served to increase the total monthly fees the lender would be able to recover.

Equal repayment periods over the life of a SACC, (while still allowing consumers the benefit of repaying early), is a desirable reform that would be straightforward for lenders administer and clearly enforceable for regulators.

Consumer leases

Consumer Action strongly agrees with the conclusions implicit in observation 6 of the Interim Report, namely that high cost consumer leases are causing vulnerable consumers significant harm, and ought to be regulated in line with other forms of consumer credit under the Credit Act. Consumer leases are currently regulated more lightly than credit contracts, which is a clear case of regulation based on form over substance—and amounts to regulatory failure. University of Melbourne Law School research has found that this uneven regulation has resulted in significant consumer harm.[16]

Consumer Action reiterates the view expressed in our initial submission that lease providers routinely structure their products to avoid existing regulation (i.e. regulatory arbitrage), and this has been a feature of the industry for many years. Consumer leases serve a similar low-income market to SACCs, and have a similar effect on consumers—absorbing a high proportion of their income, and exacerbating financial exclusion. In many cases the situation is worsened by lease provider's unfettered access to Centrepay. As highlighted in our initial submission, many consumer lease providers derive a large proportion of their income through Centrepay authorised payments—by definition, serving a client base that is dependent on welfare and then taking a

[15] The Pew Charitable Trusts, "Payday Lending in America: Policy Solutions', October 2013, available at: http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydayoverviewandrecommendationspdf.pdf.
[16] For further information, see Paul Ali, Cosima McRae, Ian Ramsay and Tiong Tjin Saw, 'Consumer Leases and Consumer Protection: Regulatory Arbitrage and Consumer Harm', *Australian Business Law Review* (2013) Vol. 41, pp. 240-269.

priority stake in their income. For example, Radio Rentals' total revenue last financial year was $197 million, $90 million of which came from Centrepay payments—or approximately 45%.[17]

Centrepay is supposed to assist low income consumers in gaining financial stability, and move towards financial inclusion. Clause 2 of the Department of Human Services', '*Centrepay Policy and Terms*' states:

> *2.1 'The objective of Centrepay is to assist Customers in managing expenses which are consistent with the purposes of their welfare payments, and reducing financial risk, by providing a facility to have regular Deductions made from their welfare payments.'*

The inclusion of consumer lease payments as allowable Centrepay Deductions, particularly without any restraint on the amount that can be deducted runs counter to the stated Centrepay objective of reducing financial risk. Consumer leases have a history of causing significant consumer detriment, and require low-income consumers to pay many times the value of common household goods over the course of the lease. In our view, the inclusion of consumer leases repayments as allowable Centrepay Deductions clearly works against financial inclusion. All other forms of consumer credit contracts, (including SACCs, which serve a similar consumer base), are not allowable Centrepay Deductions.[18]

In our initial submission we noted that the Senate had passed a Bill[19] in August 2015 which sought to remove access to Centrepay by consumer lease providers, but that the Bill has yet to be considered by the House of Representatives. We note that the Interim Report does not discuss the relationship between Centrepay and consumer leases at any length, and again we strongly encourage the Review Panel to support enactment of the Bill.

While Consumer Action clearly supports the view expressed in Perspective 1 of the Interim Report, we also feel it is necessary to highlight some of the flaws inherent in Perspective 2. The contention that consumer leases create no risk of a debt spiral is incorrect. Consumer Action has seen many cases where an unsustainably high proportion of a consumer's income is tied up in consumer leases (often through Centrepay), and this clearly exacerbates financial hardship, creating the conditions for ongoing financial exclusion. .

The following case study, highlighted in our initial submission, illustrates this dynamic:

Hilary's story

We were contacted by Hilary after she had entered into a number of consumer leases. Hilary's income is sourced through a disability support pension and a modest wage earned working part time. Hilary has an intellectual disability, and experiences difficulties learning, reading and spelling. Hilary says has no assets other than some essential household items.

[17] Credit Suisse, 'Australian ESG/SRI - Risks in payday lending and goods rental', published 3 March 2015. See also the ABC's report on Radio Rentals here: http://www.abc.net.au/news/2015-03-20/radio-rentals-reaps-90-million-in-centrelink-payments/6333690.
[18] Department of Human Services, 'Centrepay Policy and Terms', clause 4.1.
[19] *Social Security (Administration) Amendment (Consumer Lease Exclusion) Bill 2015*

Hilary entered into her first consumer lease for a mattress, bedroom suite, and cabinet in March 2013. The total payments under the lease would have been more than $8,900. The cash price of the goods was less than $3,000. Hilary entered into her second consumer lease with the same provider for a washing machine in October 2013. Total payments under the lease to amounted to more than $2,300. The cash price for the washing machine was less than $800.

Hilary was also required to purchase 'add on' insurance. We are instructed that Hilary did not know what the insurance was when she entered the lease agreements. Hilary says that she thought she would own the goods at the end of the leases, although this was not the case.

The notion that consumers can simply discontinue the lease is also incorrect, and simplistic when one considers that many lease providers charge prohibitive termination fees, creating a significant barrier to exit and effectively “locking” consumers into the lease contract. Again, our initial submission presented a case study highlighting this issue, which we reproduce below:

Sarah’s story

Sarah, a single parent relying on Centrelink payments, entered into a number of consumer leases agreements for a laptop, washing machine, refrigerator, television and entertainment unit. Sarah has a young child who has medical needs.

Each agreement was for an effective period of 36 months, and payments were made via Centrepay. Sarah says that she did not understand the legal or practical consequences of the agreements, including that she would have no right to own or buy the goods and that an early termination fee may be payable. Sarah says that she also did not know the cash price of the goods, or that she would be paying an amount significantly in excess of the cash price. Based on our calculations, Sarah would have paid the consumer lease provider more than $7,000 in excess of the cash price of the goods by the end of her contract.

At the time of entering into the contracts, Sarah's income barely covered her expenses. Her financial position was worsened when she separated from her partner. Sarah contacted the consumer lease provider to tell them that she could not afford the repayments. The lease provider said that she could not terminate the agreements without paying significant termination fees.

Consumer Action also refutes the assertion that consumer leases come with valuable add-ons and services. In our experience, these add-ons generally lack transparency and hold little value (as highlighted in ‘Hilary’s story’ above). As expressed in our response to Option 10 below, we would prefer that add-on services simply weren’t sold as they typically do nothing more than inflate the cost of consumer leases, while providing no real benefit.

Cap on consumer leases

- ***Option 9 – Introduce a cap on the maximum amount a lessor can charge. The cap would apply to a defined class of leases covering low-value goods.***

Consumer Action strongly supports this option. In our view consumer leases should be subject to the 48 per cent cap that generally applies to consumer credit contracts, applied as a finance charge on the market value of the good.

Consumer Action does not believe that this cap should be limited to a “defined class of leases”, as we see no reason to “carve out” a particular class of lease in the way SACCs have been carved out in the area of personal loans. We hold the view that all forms of consumer lease should be regulated as consumer credit contracts under the Credit Act, and the relative value of the good being leased does not substantially change the nature of the agreement—or give rise to a need for varied forms of regulation. In fact, carving out a particular class of consumer lease is likely to create further needless complexity in the National Credit Law, contributing to red-tape and further opportunities for arbitrage and avoidance.

Consumer Action notes Table 3 of the Interim Report, and the question posed on page 30, namely, “*should there be a limit on the maximum term of a consumer lease*?”. Consumer Action is aware that some consumer lease providers have been encouraging longer lease terms as a revenue strategy,[20] and in our view this must be taken into account when seeing to cap the maximum amount a lessor can charge for a consumer lease. A maximum cap of 48 per cent should stipulate that this finance charge applies to the market value of the good at the time the contract is entered into, and cannot be exceeded regardless of the length of the contract. Essentially, once the consumer has paid the market value of the good, plus a 48 per cent finance charge based on that value, then they should own the good.

In terms of determining the market value of the good, Consumer Action supports the application of s204(1) of the Credit Code which states:

"cash price" *of goods or services to which a credit contract relates means:*

> *(a) the lowest price that a cash purchaser might reasonably be expected to pay for them from the supplier; or*
>
> *(b) if the goods or services are not available for cash from the supplier or are only available for cash at the same, or a reasonably similar, price to the price that would be payable for them if they were sold with credit provided--the market value of the goods or services.*

While it may be useful to further clarify the definition of “market price”, particularly if there is any risk of providers artificially inflating such a price, in Consumer Action’s view, further clarification of the “market value” of goods should be left to ASIC or ombudsman guidance. However, we expect that in most cases the “market price” should not exceed the recommended retail price of a product, and may in fact be lower. Consumer Action does take the view that the claimed market value of the good should be required to be disclosed in the consumer lease contract, and can therefore be challenged if it appears artificially inflated. Importantly, this will also require the good being leased to also be accurately described, including make, model and year of manufacture. Generic descriptions such as “lounge” or “plasma TV” which are sometimes used in consumer lease contracts are not sufficient to accurately determine the market value of a good.

[20] http://www.thorn.com.au/IRM/PDF/1701/FullYearResultsAnnouncement

Consumer Action is aware that in some cases consumer leases are entered into for older model items, and sometimes second hand items. In each case, an alternative method of determining market value would have to be devised. This can be difficult when the goods are no longer available for purchase at a retail outlet, but in consultation with other stakeholders in the community sector, we propose the following formulations.

For unused, but older model goods, we propose that s204(1) of the Credit Code should still apply, with the addition that the value of the goods is depreciated in accordance with the Australian Tax Office (ATO) calculator. The ATO calculator provides a recognised and readily accessible tool for calculating the decline in value of older goods, and is likely to already be extensively used by many lessors.

In relation to used and second hand goods, the above formula for older model goods could be applied, with a further reduction of 10 per cent to account for the fact the goods are used.

- ***Option 10 – Include the cost of add on features and products under the cap.***

"Add-ons" are a feature of the consumer lease industry, and often lack transparency and value. In Consumer Action's view, if add on features are not included in the cost of the cap on consumer leases then they will represent a clear opportunity for lessors to artificially inflate the cost of leases by signing vulnerable consumers onto complex add-ons with little or no real value. On that basis, Consumer Action supports Option 10.

In addition to being included in the price cap, add-on features and services for consumer leases should come with a clear cooling off period of at least seven days, and require a pro-active 'opt-in' by the purchaser to ensure that they genuinely want the additional feature or service—rather than simply falling prey to high pressure sales tactics.

One area of complexity that could be clarified in the course of this review is the application of consumer guarantees and/or quality standards to goods purchased via a consumer lease. Under the Australian Consumer Law, consumer products attract a range of automatic guarantees, including that they are of an acceptable quality (safe, durable, no faults, do all the things one would normally expect them to do).[21] However, these protections do not apply to financial services.[22] Further, while the *Australian Securities and Investments Act 2001* (Cth) does include implied warranties in supplies of financial services, this only gives rise to a private contractual right. Consumer guarantees provide for statutory rights, which may also be exercised by a regulator. Further, it is not clear that the implied warranty regimes provide the same substantive level of consumer protection. In our view, this could be clarified in the laws so that consumers receive the same consumer guarantee protections even if they purchase the goods as a lease. This may go some way further to obviating the need for add-ons to do with repairs etc, noting that such existing add-ons appear to provide very limited if any protection.

Consumer Action does note the point made in the Interim Report regarding delivery costs, and we are of the view that there may be some justification in charging delivery costs separately from

[21] Competition & Consumer Act 2010 (Cth), Schedule 2, Australian Consumer Law, s 54.
[22] Competition & Consumer Act 2010 (Cth), s 131A

the general cost cap on consumer leases. In that case, we are of the view that delivery costs should be subject to their own, separate cap.

Consumer Action recommends that any cap applicable to delivery charges should be expressed as a maximum dollar amount, or based on a clear and simple formula based on distance travelled. Delivery costs would not necessarily require upfront payment, but should be itemized separately in the consumer lease and would sit outside of the general cost cap applicable to the lease and paid by instalment over the first few repayments of the lease (rather than being financed).

Lease affordability

Consumer Action continues to encounter cases in which consumers are over-committed, often paying for multiple consumer leases—and this clearly raises the issue of affordability. ASIC and University of Melbourne Law School research supports the observation that the high cost of consumer leases causes consumer harm, and works counter to financial inclusion.[23]

In addition to Hilary's story above, Consumer Action also raised Margaret's story in our initial submission, and we reproduce it again here as a typical example of what we encounter through our financial counselling and legal practices, in relation to consumer leases:

Margaret's story

A financial counsellor in regional Victoria contacted us about Margaret, who had entered into multiple consumer leases with a consumer lease provider.

Margaret is in her sixties and relies on a disability support pension. She suffers from multiple, chronic illnesses. Margaret visited the consumer lease provider with the intention of purchasing an inexpensive laptop on lay-buy. She had recently lost her husband, and was struggling to recover from her loss. She wanted the laptop for recreational purposes. While she was looking at the laptops, she was approached by a staff member. Margaret advised the representative that she wanted to lay-by a laptop. The staff member told her it would be better to rent the laptop, and that she could rent the laptop for as long as she liked and then just "buy it at the end".

Margaret told the staff member that she was on a disability support pension, and so was unlikely to get approved by the lease provider. The representative encouraged her to "give it a try" and assisted her to complete the forms. The total cost of the laptop over the 60 month term of the contract was around $3,270. The tax invoice from the retailer shows that the insurable value of the laptop was $1,318 including an amount for a three year warranty.

[23] For further information, see Paul Ali, Cosima McRae, Ian Ramsay and Tiong Tjin Saw, Consumer Leases and Consumer Protection: Regulatory Arbitrage and Consumer Harm, *Australian Business Law Review* (2013) Vol. 41, pp. 240-269; Australian Securities and Investments Commission, 'REP 447: Cost of consumer leases for household goods', September 2015, available at http://download.asic.gov.au/media/3350956/rep-447-published-11-september-2015.pdf; Australian Securities and Investments Commission, '15-249MR ASIC finds the cost of consumer leases can be as high as 884%', 11 September 2015, available at: http://www.asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-249mr-asic-finds-the-cost-of-consumer-leases-can-be-as-high-as-884/

Margaret was never told that the total amount payable was so much higher than the retail price. She says she would not have entered into the contract if she had known that. Margaret feels she was misled about how much she had to pay.

- ***Option 11 – Cap the amount of net income that can be used to service all lease repayments.***

Consumer Action supports this option and refers to our response to Option 3 above, where we propose a protected earnings cap of 10 per cent of net income, applicable across both SACCs, consumer leases and medium amount credit contracts. We note that 5 per cent of net income has also been proposed as a realistic protected earnings cap, and we would support this level if it were to be solely applied to consumer leases, while not applying to other credit obligations.

<u>Early termination fees</u>

- ***Option 12 – Prescribe the maximum that can be charged on early termination of the contract.***

Consumer Action supports this option and notes that the unregulated nature of early termination fees means that consumers are often exploited, and "locked in" to contracts by the prohibitive cost of terminating early. This situation runs counter to the policy objective of promoting financial inclusion. Instead, consumers are left to continue leasing a good which would be far cheaper to buy outright – even in situations where their circumstances have changed, and they may now be able to make that outright purchase.

Accordingly, the powers in the Credit Act identified by the Review Panel should be used to set a reasonable formula for early termination of a consumer lease. Consumers should certainly not continue to be required to pay out the full value of the lease contract.

More work will have to be done to determine an exact formula for devising a fair early termination fee, although in Consumer Action's view the principle established *in Citicorp Australia Ltd v Hendry* [1985] 4 NSWLR 1 that the lessor must provide the consumer with a benefit equivalent to the difference between the value of the leased goods at the time they are returned to the lessor with the value they would have at the end of the lease term, provides a sound basis for any such formula.

Such a formula should acknowledge that lessors can and do, or have the opportunity to, re-hire or sell ex-rental goods. As such, the formula must not allow a termination a fee to recover future returns for those goods. Any formula should provide that the only liquidated damages payable should be for administrative or collection costs

- ***Option 13 – Provide a remedy for consumers similar to that in section 78 of the National Credit Code allowing action to be taken for an unconscionable termination charge.***

Consumer Action does not support this option. In our view, even if the proposed protection existed, it would be under-utilised, and too many consumers subjected to unreasonable termination fees would remain effectively unprotected. This option would simply create an enforcement burden and result in less effective consumer protection than Option 12.

Please contact Zac Gillam, Senior Policy Officer on 03 9670 5088 or at zac@consumeraction.org.au if you have any questions about this submission.

Yours sincerely
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