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Attention: SACC Review Secretariat
Financial System and Services Division, Markets Group
The Treasury
Langton Crescent
PARKES ACT 2600
By email to: consumercredit@treasury.gov.au

22 January 2016

Dear Sir/Madam,

Credit Corp Group Limited (**Credit Corp**) is pleased to provide a response to the Interim report on the review of small amount credit contract (**SACC**) laws, published in December 2015.

Part 1 – Executive Summary

1.1 The Panel correctly identifies compliance with responsible lending provisions and unsustainably high rates of repeat borrowing leading to a debt spiral as key issues in the SACC segment.[1] The Panel notes that these issues are almost exclusively confined to short-term SACCs with durations of up to 90 days.[2] The Panel also correctly identifies the importance of encouraging longer-term SACCs with durations of more than 90 days as these are inherently associated with affordable repayments and economic incentives for the lender to practice responsible lending.[3]

1.2 It is clear that longer-term SACCs of more than 90 days are an appropriate solution to responsibly deliver financial inclusion to the 0.5 million consumers taking out SACCs each year. The evidence shows that repayments on longer-term loans average an affordable 6.4% of borrower net income[4] and that these loans are not associated with high rates of repeat borrowing. Longer-term SACCs more closely emulate mainstream lending products, providing an inbuilt incentive for the lender to practice responsible lending. This is because they are much lower yielding and put more capital at risk over a longer period.[5]

1.3 While the Panel suggests some appropriate options to address the issues identified,[6] it is Credit Corp's contention that these options need to be applied in a bifurcated way to provide responsible solutions for the large number of consumers active in the segment each year. Only a bifurcated legislative regime, differentiating those SACCs with terms of more than 90 days from other SACCs, will achieve the objective of responsibly delivering financial inclusion to the large number of Australians excluded from mainstream financial products.

1.4 The evidence shows that the uniform application of legislative controls creates unintended consequences. Prior to the introduction of the SACC laws in July 2013, the effective uniform prohibition arising from an unrealistically low interest rate cap in some States led to a proliferation of high cost shop-front avoidance models, a disaggregated industry and very poor consumer outcomes. The July 2013 reforms provided for a more realistic rate cap which has driven more transparent online competition, and thereby largely eliminated the various shop-front avoidance models, and industry consolidation which has facilitated more effective regulatory supervision and enforcement.

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[1] Review of the small amount credit contract laws, Interim report, December 2015, p.3 (Observations 2 and 3) and p.12 which states "*Several submissions recognised that the repeat use of SACCs can lead to unmanageable debt and debt spirals. This view is also supported by academic literature.*"

[2] Review of the small amount credit contract laws, Interim report, December 2015, p.9 which states *"Based on evidence provided during the consultation process, it appears the repeat use of SACCs with terms of up to 90 days is common practice in Australia."*

[3] Review of the small amount credit contract laws, Interim report, December 2015, p.12 which states *"… evidence presented during consultations suggesting [sic] that longer term credit is more affordable relative to repeat use of shorter term loans"*. In comparing short-term SACCs to longer term SACCs, the Interim report also notes at page 11 that *"having less capital at risk also means that lenders may be less prudent when providing credit"*.

[4] Review of the small amount credit contract laws, Submission by Credit Corp, 15 October 2015, p.45, Table 3 (weighted average of the last three columns).

[5] Review of the small amount credit contract laws, Interim report, December 2015, p.11 which states *"… in comparison to a larger loan over a longer time period, the lender's capital is at risk for a shorter period of time when a customer borrows small amounts repeatedly"*.

[6] Review of the small amount credit contract laws, Interim report, December 2015, p.13 (Options 2 and 3).

1.5 Poor responsible lending compliance and excessive rates of repeat borrowing for loans of up to 90 days duration under the present regime are unintended consequences of uniform legislative controls which apply to all SACCs with terms ranging from 16 days to 12 months. As recognised by the Panel, longer-term SACCs provide lenders with lower returns and the increased risk of credit losses. In accordance with established theories of rational commercial behaviour, almost all SACC participants have focussed on shorter-term loans, creating a dysfunctional situation where 85% of SACCs are issued for terms of up to 90 days with repayments which, on average, account for 14% of borrower income leading to a high rate of repeat borrowing and debt spiral.[7] Only a bifurcated regime differentiating short-term SACCs of up to 90 days from longer-term loans of more than 90 days will both limit the incidence of harm and address the economic imbalance between the two types of SACC, promoting responsible competition to drive out predatory avoidance models.

1.6 Supplementing existing principle-based responsible lending obligations with bright line prohibitions, as suggested by the Panel, exacerbates the risk of unintended consequences. In particular, a uniform prohibition on repeat borrowing is unlikely to encourage responsibly delivered longer-term SACCs as the Panel speculates.[8] Rather, the evidence to date suggests that such an indiscriminate approach will see a return to high cost shop-front avoidance models, a disaggregated industry and poorer consumer outcomes. The rationale for principle-based obligations is to provide flexibility to minimise the scope for unintended consequences. In moving to bright line repeat borrowing tests the Panel must be mindful of the need to positively encourage longer-term SACCs as an appropriate solution to financial exclusion.

1.7 Credit Corp supports the implementation of the Panel's suggested bright line controls over repeat borrowing subject to amendments to introduce a bifurcated approach and limit the scope for unintended consequences. Credit Corp supports replacement of the rebuttable presumption of unsuitability if a consumer has had two or more SACCs in the preceding 90 days with a bright line prohibition (Option 2 of the Interim report),[9] but only where the third or further SACC is for a term of up to 90 days. Credit Corp supports an extension of the bright line protected earnings amount (Option 3 of the Interim report),[10] but only as an affordability test in addition to the rebuttable presumption of unsuitability if the consumer has had two or more SACCs in the preceding 90 days, where the third or further SACC is a longer-term loan with a term of more than 90 days and the repayment test is limited to repayments on the third or further loan and is reduced to 5% of net income (rather than 10% as per Option 3 of the Interim report).

1.8 These amendments avoid the unintended consequence of excluding consumers of unsustainable short-term SACCs from the opportunity to move into a more affordable longer-term SACC as a means of avoiding hardship and providing a pathway to mainstream financial inclusion, in accordance with the objectives identified by the Panel.[11] This was the rationale for the use of presumptions, rather than prohibitions, in the existing legislation.[12]

1.9 A bifurcated approach, applying a bright line prohibition on further shorter-term loans and supplementing existing obligations with a tight bright line affordability test for longer-term SACCs, deals with the shortcomings of the present principles-based approach, will avoid unintended consequences and will enable returning borrowers to access affordable, longer-term SACCs.

1.10 Credit Corp's amendments to the Panel's proposals are in line with recent international regulatory developments in the segment. For the reasons outlined above, the US federal regulator (Consumer Financial Protection Bureau) is proposing bifurcated legislation. For loans of up to 45 days duration the US regulator proposes a bright line prohibition of no more than 3 such short term loans without a 60 day cooling off period. For loans of more than 45 days duration the US regulator proposes that lenders either comply with responsible lending obligations or, as a safe harbour for loans of up to 6 months duration, limit repayments to no more than 5% of pre-tax income over the repayment period. The US has a long history in the segment and the regulator has undertaken an extensive analysis of the market to arrive at these proposals.

1.11 Finally, bifurcation will also have the benefit of providing an environment for competition from mainstream financial services providers, with a strong commitment to sustainable business practices and who are capable of providing safe and affordable longer-term SACCs in compliance with general responsible lending obligations.

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[7] Review of the small amount credit contract laws, Submission by Credit Corp, 15 October 2015, p.45, Table 3.

[8] Review of the small amount credit contract laws, Interim report, December 2015, p.12 which states *"Lenders would likely respond by extending the maturity of the loans,…"*.

[9] Review of the small amount credit contract laws, Interim report, December 2015, p.13.

[10] Review of the small amount credit contract laws, Interim report, December 2015, p.13.

[11] Review of the small amount credit contract laws, Interim report, December 2015, p.3 (Observation 1).

[12] Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth), p.58, par 4.31 which states "*The use of presumptions, rather than a prohibition, allows for greater flexibility and acknowledges that there may be situations where a refinance would not result in financial hardship (such as where it results in lower repayments which the consumer can afford)*".

Bifurcation will limit the application of pejorative descriptions, such as 'payday loan', to only those short-term SACCs with terms of up to 90 days reflecting existing local and international precedents. Mainstream providers will only enter the segment to provide responsible longer-term solutions if there is a legislative framework which ensures that these products are differentiated from harmful short-term products which attract pejorative descriptions.

Part 2 – Trends

2.1 On 1 July 2010, responsibility for the regulation of consumer credit was transferred from the States and Territories to the Commonwealth with the commencement of the National Consumer Credit Protection Act 2009 (**the Credit Act**). At that time, many lenders offering small amount loans were operating out of shopfront premises that were situated in low socio-economic areas.[13] Uniform laws were introduced by several States which capped the permissible interest rate for all credit products at a level which was unrealistic for small amount loans. These laws included the comprehensive 48% cap in New South Wales, Queensland and the Australian Capital Territory.[14]

2.2 Enhancements to the Credit Act, which included specific provisions for SACCs, were introduced by the Consumer Credit Legislation Amendment (Enhancements) Act 2012 (**the Enhancements Act**). The Enhancements Act provided a concessional cap on fees for SACCs and contained a number of additional protections and obligations that apply specifically to SACCs.

2.3 Prior to the commencement of the Enhancements Act in July 2013, providers of small amount loans utilised various techniques to circumvent the 48% interest rate cap applicable in some States. These techniques have been the subject of regulatory and consumer action, for example the regulator's action against Fast Access Finance[15] (which involved a diamond trading scheme) and the class actions against Cash Converters[16] (which involved an early repayment election and deferred establishment fee scheme). Techniques such as these were utilised by many industry participants to avoid rate caps which were widely recognised as unrealistically low for small amount loans.

2.4 Since the commencement of the Enhancements Act, these avoidance practices have largely been eliminated and ASIC has reported industry consolidation and a transition towards online lending.[17] Strong compliance with the rate caps incorporated in the Enhancements Act means that consumers are no longer being charged higher rates pursuant to the avoidance practices. Consolidation and the transition towards online lending has facilitated more effective regulatory supervision and enforcement.

2.5 Unfortunately, in the same way that uniform State interest rate caps previously led to avoidance and unintended consequences in the small amount lending sector, the uniform application of the Enhancements Act to all small amount loans with terms ranging from 16 days right up to 12 months has also led to unintended consequences. One of the key objectives of the Enhancements Act was to encourage lenders to offer longer-term SACCs because these were recognised as more affordable for consumers.[18] This objective has not been achieved.

2.6 The vast majority (85%) of SACCs being issued at present are for durations of less than 90 days (or an average of just 37 days) and the repayments on such loans absorb a relatively high average of 14% of a consumer's after tax income each payment cycle.[19] The Panel has also noted that repeat borrowing is commonplace for loans with durations of up to 90 days[20] and that the degree of repeat borrowing occurring at present is excessive and is causing consumers financial harm.[21]

2.7 It is clear that the prevalence of high cost loans of durations of less than 90 days and the high rate of repeat borrowing are consequences of the uniform application of fee caps and responsible lending controls to all SACCs, despite the considerable economic incentives that exist for lenders to issue SACC for very short terms. Short-term SACCs of up to 90 days provide lenders with a much higher gross yield because the 20% establishment fee is applied to a shorter period. The fact that repayments on short-term SACCs represent a much higher proportion of

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[13] Review of the small amount credit contract laws, Submission by ASIC, October 2015, p.11, par 45.

[14] The Regulation of Short Term, Small Amount Finance, Regulation Impact Statement, June 2011, p.9, Table 1.

[15] *Australian Securities and Investments Commission v Fast Access Finance Pty Ltd* [2015] FCA 1055.

[16] *Gray v Cash Converters International Limited* [2014] FCA 420.

[17] Review of the small amount credit contract laws, Submission by ASIC, October 2015, p.11, par 46.

[18] Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth) p. 68, par 5.34 which states *"Setting the cap at this level would allow for a viable small amount lending industry to continue while meeting the Government's object of indirectly encouraging longer term loans."*

[19] Review of the small amount credit contract laws, Submission by Credit Corp, 15 October 2015, p.45, Table 3.

[20] Review of the small amount credit contract laws, Interim report, December 2015, p.9 which states *"Based on evidence provided during the consultation process, it appears the repeat use of SACCs with terms of up to 90 days is common practice in Australia."*

[21] Review of the small amount credit contract laws, Interim report, December 2015, p.3 (Observation 3).

borrower income creates a form of dependency which results in repeat borrowing, which further improves lender returns through the ability to charge additional establishment fees without incurring further marketing costs. Lending smaller amounts over shorter terms puts less capital at risk. The Panel has recognised that lenders are economically motivated to encourage repeat borrowing[22] and that despite longer-term loans being more affordable for consumers[23], lenders are economically discouraged to provide them[24].

Part 3 – Responses to the Panel's Options

Option 1 – Reduce the establishment fee for subsequent loans for a returning customer from 20 per cent to 10 per cent[25]

3.1 Credit Corp does not support Option 1. Credit Corp has identified several problems with this Option, many of which arise from the anomalous situation that would result where one customer can be offered identical loans from two lenders at the same time, with one lender being subject to a 20% establishment fee cap and the other lender being subject to a 10% cap. Such an obvious regulatory arbitrage is likely to lead to avoidance practices and unwarranted complexity in the context of a proposal which the Panel itself acknowledges is not sufficient to address excessive repeat borrowing[26].

3.2 Option 1 creates a very obvious avoidance opportunity through referral to an alternative lender. For example, lender A could refer a customer to lender B in circumstances where a customer is a returning customer for lender A but not for lender B, thus allowing a full 20% establishment fee to be charged. If the two lenders are related entities or parties to a referral arrangement, the intent of Option 1 would be entirely circumvented. It is possible that some specific anti-avoidance measures could be implemented, however these are likely to add complexity and costs and increase the scope for further unintended consequences.

3.3 Such a structure may also stifle competition to the detriment of consumers. A new lender may be able to offer more sustainable, longer term loans with lower monthly fees and significant benefits for the consumer. The new lender will however find it difficult to compete against the mandated lower establishment fee of an existing lender to defray its customer acquisition costs and offset other economic disadvantages associated with providing longer and more sustainable loans. As a consequence, consumers are more likely to become trapped with an existing lender offering less affordable repayments increasing their exposure to the risk of debt spirals.

3.4 Option 1 will require a re-evaluation of the 20% cap because the economic models used to set the existing caps assume a level of repeat borrowing. In seeking to achieve greater alignment with lender economics[27] it will be necessary to offset the reduction in establishment fees generated from repeat borrowing with an increase in the initial establishment fee. Such an exercise is likely to be complex and heavily contested by stakeholders.

3.5 Option 1 introduces the complexity of requiring the definition of a returning customer. For example, for what period would a customer have to go without a SACC before they can be considered a new customer again? Or is a customer who is engaged in a different product or service with a lender a new customer or a returning customer if they have not previously had a SACC with that lender? Such questions would need to be addressed in specific detail.

Option 2 – Replace the rebuttable presumption that a SACC is unsuitable if a consumer 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[28]

3.6 As noted in paragraphs 2.5 and 2.7 above, poor levels of compliance with responsible lending obligations and repeat borrowing for loans of up to 90 days duration under the present regime are unintended consequences of uniform legislative controls which apply to all SACCs with terms ranging from 16 days to 12 months. In seeking to address these issues, only a bifurcated legislative regime differentiating short-term SACCs of up to 90 days from longer-term loans of more than 90 days will both limit the incidence of harm and promote responsibly provided

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[22] Review of the small amount credit contract laws, Interim report, December 2015, p.10 which states *"Repeat borrowing appears to enhance the economic returns for SACC providers and some business models appear to reflect this."*

[23] Review of the small amount credit contract laws, Interim report, December 2015, p.12 which states *"… evidence presented during consultations suggesting [sic] that longer term credit is more affordable relative to repeat use of shorter term loans"*.

[24] Review of the small amount credit contract laws, Interim report, December 2015, p.11 which states *"… in comparison to a larger loan over a longer time period, the lender's capital is at risk for a shorter period of time when a customer borrows small amounts repeatedly"*.

[25] Review of the small amount credit contract laws, Interim report, December 2015, p.12 (Option 1).

[26] Review of the small amount credit contract laws, Interim report, December 2015, p.13 which states "*Option 1 is not in itself sufficient to deter repeat borrowing because SACC providers would still have an incentive to offer repeat loans to returning consumers.*".

[27] Review of the small amount credit contract laws, Interim report, December 2015, p.13 which states "*The advantages of this policy option are that it ensures that the establishment fees more closely align with actual costs incurred,…*".

[28] Review of the small amount credit contract laws, Interim report, December 2015, p.13 (Option 2).

longer-term SACCs to deliver financial inclusion to the large number of Australians excluded from mainstream financial products.

3.7 The Panel correctly identifies compliance with responsible lending provisions and unsustainably high rates of repeat borrowing leading to a debt spiral as key issues in the SACC segment.[29] The Panel notes that these issues are almost exclusively confined to short-term SACCs with durations of up to 90 days.[30] The Panel also correctly identifies the importance of encouraging longer-term SACCs with durations of more than 90 days as these are inherently associated with affordable repayments and economic incentives for the lender to practice responsible lending.[31]

3.8 It is clear that longer-term SACCs of more than 90 days are an appropriate solution to responsibly deliver financial inclusion to the 0.5 million consumers taking out SACCs each year. The evidence shows that repayments on longer-term loans average an affordable 6.4% of borrower net income[32] and that these loans are not associated with high rates of repeat borrowing. Longer-term SACCs more closely emulate mainstream lending products, providing an inbuilt incentive for the lender to practice responsible lending. This is because they are much lower yielding and put more capital at risk over a longer period.[33]

3.9 As recognised by the Panel, longer-term SACCs provide lenders with lower returns and the increased risk of credit losses. Consistent with established theories of rational commercial behaviour, almost all SACC participants have focussed on shorter-term loans, creating a dysfunctional situation where 85% of SACCs are issued for terms of up to 90 days with repayments which, on average, account for 14% of borrower after tax income leading to a high rate of repeat borrowing and debt spirals.[34] Only a bifurcated regime differentiating short-term SACCs of up to 90 days from longer-term loans of more than 90 days will both limit the incidence of harm and address the economic imbalance between the two types of SACC, promoting responsible competition to drive out predatory avoidance models.

3.10 Supplementing existing principle-based responsible lending obligations with bright line prohibitions, as suggested by the Panel, exacerbates the risk of unintended consequences. In particular, a uniform prohibition on repeat borrowing is unlikely to encourage responsibly delivered longer-term SACCs as the Panel speculates.[35] Rather, the evidence to date suggests that such an indiscriminate approach will see a return to high cost shop-front avoidance models, a disaggregated industry and poorer consumer outcomes. The rationale for principle-based obligations is to provide flexibility to minimise the scope for unintended consequences. In moving to bright line repeat borrowing tests the Panel must be mindful of the need to positively encourage longer-term SACCs as an appropriate solution to financial exclusion consistent with the intention of previous law reform.

3.11 Credit Corp supports replacement of the rebuttable presumption of unsuitability if a consumer has had two or more SACCs in the preceding 90 days with a bright line prohibition (Option 2 of the Interim report)[36], but only where the third or further SACC is for a term of up to 90 days.

3.12 Option 2 should not be considered for uniform implementation as it will result in financial exclusion whereby consumers who apply for SACCs will be declined even in circumstances where the new loan could be a longer-term loan with affordable repayments.

3.13 It is crucial to avoid the unintended consequence of depriving consumers of unsustainable short-term SACCs from the opportunity to move into a more affordable longer-term SACC as a means of avoiding hardship and

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[29] Review of the small amount credit contract laws, Interim report, December 2015, p.3 (Observations 2 and 3) and p.12 which states "*Several submissions recognised that the repeat use of SACCs can lead to unmanageable debt and debt spirals. This view is also supported by academic literature.*"

[30] Review of the small amount credit contract laws, Interim report, December 2015, p.9 which states *"Based on evidence provided during the consultation process, it appears the repeat use of SACCs with terms of up to 90 days is common practice in Australia."*

[31] Review of the small amount credit contract laws, Interim report, December 2015, p.12 which states *"… evidence presented during consultations suggesting [sic] that longer term credit is more affordable relative to repeat use of shorter term loans"*. In comparing short-term SACCs to longer term SACCs, the Interim report also notes at page 11 that *"having less capital at risk also means that lenders may be less prudent when providing credit"*.

[32] Review of the small amount credit contract laws, Submission by Credit Corp, 15 October 2015, p.45, Table 3 (weighted average of the last three columns).

[33] Review of the small amount credit contract laws, Interim report, December 2015, p.11 which states *"… in comparison to a larger loan over a longer time period, the lender's capital is at risk for a shorter period of time when a customer borrows small amounts repeatedly"*.

[34] Review of the small amount credit contract laws, Submission by Credit Corp, 15 October 2015, p.45, Table 3.

[35] Review of the small amount credit contract laws, Interim report, December 2015, p.12 which states *"Lenders would likely respond by extending the maturity of the loans,…"*.

[36] Review of the small amount credit contract laws, Interim report, December 2015, p.13 (Option 2).

finding a path to mainstream financial inclusion, in accordance with the objectives identified by the Panel.[37] This was the rationale for the use of presumptions, rather than prohibitions, in the existing legislation.[38]

3.14 A bifurcated approach, applying a bright line prohibition on further shorter-term loans and supplementing existing obligations with a tight bright line affordability test for longer-term SACCs (described in the response to Option 3 below), deals with the shortcomings of the present principle-based approach to repeat borrowing, will avoid unintended consequences and will enable returning borrowers to access affordable, longer-term SACCs.

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[39]

3.15 Option 3 is presented by the Panel as a control over repeat borrowing as an alternative to the existing rebuttable presumption of unsuitability. However, in the form proposed it is a bright line test to effectively replace the general responsible lending obligations to assess and verify the affordability of repayments for all SACCs and its application is not confined to circumstances of repeat borrowing.

3.16 The effective replacement of general responsible lending obligations with a bright line affordability test for all SACCs seems to be predicated on the view that general responsible lending controls will never be effective in the SACC segment. The Panel states that the specific obligations for SACCs under the existing legislation were introduced because it was recognised that responsible lending obligations were insufficient to protect consumers in the small amount loan segment.[40] The Panel refers to stakeholder feedback describing responsible lending obligations as 'difficult to understand' and 'abstract and highly principle-based'.[41] The Panel cites New Zealand academic commentary to support the view that reliance on responsible lending will never be sufficient.[42] At the same time the Panel observe a priority need for ASIC's enforcement of the responsible lending obligations.[43]

3.17 Credit Corp does not support the view that the affordability component of the responsible lending obligations is 'abstract' or 'difficult to understand'. It involves making inquiries into income and expenditure to determine whether there is a sufficient surplus to meet repayments. It also involves undertaking adequate verification of the accuracy of the information used to make such an assessment. Poor compliance with such mechanical obligations should, as the Panel observes, be the subject of enforcement action by the regulator.

3.18 General responsible lending obligations should not be replaced for all SACCs. During the Sydney group consultation meeting Credit Corp attended, representatives from ASIC indicated that there were a number of responsible lending enforcement actions in advanced stages and expressed a degree of confidence in the prospects for success from these actions. It must be recognised that the Enhancements Act has been in place for less than three years and it is still relatively early for responsible lending enforcement actions to reach fruition and judicial precedent to be established in relation to the legislation. It would be premature to replace relatively new legislation without proper evidence of flaws arising from failed enforcement action.

3.19 Credit Corp is concerned that the replacement of responsible lending obligations with a bright line test for all SACCs will create unintended consequences. There is a risk that layering further uniform bright line prohibitions, in the absence of enforcement and judicial interpretation of existing provisions, will result in over-regulation and inconsistencies between laws applicable to SACCs and other forms of consumer credit. There is a risk that such bright line legislation will exacerbate financial exclusion and lead to a return to widespread avoidance.

3.20 Credit Corp is, however, supportive of the extension of the bright line protected earnings amount (Option 3 of the Interim report),[44] but only as an affordability test in addition to the rebuttable presumption of unsuitability if the consumer has had two or more SACCs in the preceding 90 days, where the third or further SACC is a longer-term loan with a duration of more than 90 days and the repayment test is limited to repayments on the third or further loan and is reduced to 5% of net income (rather than 10% as per Option 3 of the Interim report). This modification restricts the application of the test to circumstances of repeat borrowing and complements Credit Corp's proposed

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[37] Review of the small amount credit contract laws, Interim report, December 2015, p.3 (Observation 1).

[38] Revised Explanatory Memorandum, Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Cth), p.58, par 4.31 which states "*The use of presumptions, rather than a prohibition, allows for greater flexibility and acknowledges that there may be situations where a refinance would not result in financial hardship (such as where it results in lower repayments which the consumer can afford)*".

[39] Review of the small amount credit contract laws, Interim report, December 2015, p.13 (Option 3).

[40] Review of the small amount credit contract laws, Interim report, December 2015, p.8.

[41] Review of the small amount credit contract laws, Interim report, December 2015, p.7.

[42] Review of the small amount credit contract laws, Interim report, December 2015, p.8.

[43] Review of the small amount credit contract laws, Interim report, December 2015, p.3 (Observation 2).

[44] Review of the small amount credit contract laws, Interim report, December 2015, p.13 (Option 3).

modification to Option 2 for short-term SACCs to deliver a bifurcated set of bright line controls over repeat borrowing.

3.21 Our view is that Option 3 requires amendment such that the affordability test applies solely to the current loan being assessed rather than all SACCs and/or consumer leases. Our rationale for this is similar to our concerns with a blanket application of Option 2, in that if Option 3 applies to all SACCs, this test will almost certainly lead to further financial exclusion by prohibiting a further SACC from being offered. That is because, as noted below, any one existing SACC is very likely to be absorbing 10% (or very close to 10%) of the borrower's after tax income. This would have the result of depriving consumers of the opportunity to move into a more affordable longer-term SACC as a means of avoiding hardship and providing a pathway to mainstream financial inclusion (an objective identified by the Panel). This is also unjustified given that any overlap between two SACCs is likely to be for a short duration in any event (in many instances overlap will be limited to the first repayment cycle of the second SACC) and given that the general responsible lending obligations and the rebuttable presumption of unsuitability will continue to operate to ensure that aggregate loan repayments are affordable.

3.22 Credit Corp's submission to the review of the SACC laws[45] demonstrates that two-thirds of SACCs with durations of 90 days or less absorb more than 10% of a consumer's after-tax income. Only 11% absorb less than 5% of income. Therefore, the implementation of Option 3 in its existing form is likely to result in 89% of SACC applicants being automatically declined for a new SACC when they have an existing short-term SACC ('payday loan') even where the new loan is a more affordable, longer-term SACC that may assist in avoiding a debt spiral. Testing each SACC for affordability (less than 5% of income) will limit the scope for abuse by ensuring that the further loan is clearly affordable and promotes responsible financial inclusion through longer-term SACCs.

3.23 Combining amended versions of Option 2 and Option 3 as is proposed above would deliver a bifurcated approach by applying a bright line prohibition on further short-term loans and supplementing existing obligations with a tight bright line affordability test for longer-term SACCs. This would address the shortcomings of the present principles-based approach to repeat borrowing, will avoid unintended consequences and will enable returning borrowers to access affordable, longer-term SACCs.

<u>Option 4 – Introduce a default window, where no default fees can be charged until the consumer has missed a payment by one payment cycle.</u>[46]

<u>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).</u>[47]

<u>Option 6 – Cap default fees as a percentage of the amount outstanding on the SACC.</u>[48]

3.24 Credit Corp does not profit from consumer arrears and does not exacerbate the impact of any hardship a defaulting borrower may be suffering. Credit Corp charges a single cost-recovery late payment fee of $10 for each payment reversal, and this can only be charged across two payment cycles for a maximum of $20 for each instance of arrears. We encourage customers to contact us in advance of a missed payment and will not apply any charges when this occurs.

3.25 Both weekly and fortnightly repayment cycles are commonplace in the SACC sector. Credit Corp's recommendation is the adoption of Option 5, limiting the fees which can be charged to $10 per repayment cycle for a missed payment. In our experience this provides for an adequate response to the arrears event.

<u>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).</u>[49]

<u>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.</u>[50]

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[45] Review of the small amount credit contract laws, Credit Corp's submission, p.48.

[46] Review of the small amount credit contract laws, Interim report, December 2015, p.16 (Option 4).

[47] Review of the small amount credit contract laws, Interim report, December 2015, p.17 (Option 5).

[48] Review of the small amount credit contract laws, Interim report, December 2015, p.17 (Option 6).

[49] Review of the small amount credit contract laws, Interim report, December 2015, p.18 (Option 7).

[50] Review of the small amount credit contract laws, Interim report, December 2015, p.19 (Option 8).

3.26 Credit Corp charges no fee for early repayment and waives the monthly fee for any unused portion of the original term. We support the implementation of both Option 7 and Option 8.

3.27 Option 7 will assist in avoiding scenarios whereby consumers who could repay a SACC more quickly are disincentivised to do so. Credit Corp's recommendation is that monthly fees cannot be brought to account until they are actually due and owing (as a new month has commenced) and all future monthly fees which would have been due to be incurred must be waived when the outstanding balance of a SACC is fully repaid.

3.28 Option 8 is necessary to discourage avoidance and fee-maximisation behaviour such as the front-ending of loan repayments identified in many submissions to the Panel to date.

Part 4 – A large marketplace and an achievable solution

4.1 Taking into account the issue of affordability and repeat borrowing, the economic factors identified by the Panel and the large market of 0.5 million consumers per annum there are two regulatory priorities. Limits on repeat borrowing should be tightened for short-term SACCs to remove the existing incentive to issue unaffordable loans. Bifurcation should be introduced to the legislation to encourage mainstream operators to enter the market to service the sizeable demand with affordable and responsible longer-term SACCs.

4.2 Simply taking steps to uniformly tighten restrictions will not provide consumers with an affordable alternative. Until the legislation recognises that longer term loans are more like a mainstream loan product and differentiates these from true 'payday loans' with terms of up to 90 days, mainstream lenders capable of responsibly providing affordable loans will not be able to operate within the segment to service demand, which will be to the immediate and long term detriment of consumers of small amount loans. Instead, the segment will continue to be dominated by providers with a track record of avoidance activity and there will be unintended consequences.

4.3 The observations in relation to SACCs presented by the Panel in the Interim report are sound and accurate and the options identified can, with minor amendment, achieve both regulatory priorities. In summary, leveraging the options presented by the Panel, this can be achieved by the following implementation:

Panel's Option	Recommended implementation/ amendments
Option 2 – Replace the rebuttable presumption that a SACC is unsuitable if a consumer 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	In circumstances where the loan being assessed is a SACC with a duration of 90 days or less, replace the rebuttable presumption that a SACC is unsuitable if a consumer 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
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 now more than 10 per cent of net income	In circumstances where the loan being assessed is a SACC with a duration of greater than 90 days and the rebuttable presumption is triggered, repayments on that loan cannot exceed 5 per cent of net income.
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)	Maintain the current maximum amount recoverable for default of a SACC but introduce a supplementary cap to limit default fees to $10 per repayment cycle for a missed payment.
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)	Provide SACC consumers with a benefit for early repayment by waiving the monthly fee for any unused portion of the original term.
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	Require SACCs to have equal minimum repayments over the life of the loan.

4.4 Credit Corp's proposed amendments to the Panel's proposals are in line with recent international regulatory developments in the segment. For the reasons identified above, the US federal regulator (Consumer Financial Protection Bureau) is proposing bifurcated legislation. For loans of up to 45 days duration the US regulator proposes a bright line prohibition of no more than 3 such short term loans without a 60 day cooling off period. For loans of more than 45 days duration the US regulator proposes that lenders either comply with responsible lending obligations or, as a safe harbour for loans of up to 6 months duration, limit repayments to no more than 5% of pre-tax income over the repayment period. The US has a long history in the segment and the regulator has undertaken an extensive analysis of the market to arrive at these proposals.

4.5 Finally, bifurcation will also have the benefit of providing an environment for competition from mainstream financial services providers with a strong commitment to sustainable business practices and who are capable of providing safe and affordable longer-term SACCs in compliance with general responsible lending obligations. Bifurcation will limit the application of pejorative descriptions, such as 'payday loan', to only those short-term SACCs with terms of up to 90 days reflecting existing local and international precedents. Mainstream providers will only enter the segment to provide responsible longer-term solutions if there is a legislative framework which ensures that these products are differentiated from harmful short-term products which attract pejorative descriptions.

Please feel free to contact us to further discuss our recommended implementation of the Options presented by the Panel.

Yours faithfully,

Thomas Beregi
Chief Executive Officer