Finance Industry Delegation

Supplementary Submission in response to the Interim Report into

Review of the small amount credit contract laws

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DISCLAIMER

It is noted that under the subheading "*Scope of Interim Report*", on page 2, there is the statement, *"The interim report does not cover all the issues that the Panel is required to consider… the issues covered in the interim report tend to be the matters where stakeholders had the broadest range of views and which generated most discussion…*".

With this in mind and as invited by the Treasury Secretariat, on behalf of the Review Panel, in their email to the Delegation as a stakeholder on 22 December 2015, the Finance Industry Delegation presents this supplementary submission based on the contents of the Interim Report.

However, the Delegation reserves the right to offer the Review Panel different views in the event that the other issues, and the Panel's options concerning these, are discovered to negatively impact upon the expressed views of the Delegation included in this supplementary submission, or materially change the impact of the options listed in the Interim Report, or the Delegation's preferences in regard to these options.

FINANCE INDUSTRY DELEGATION

RESPONSE TO THE SACC REVIEW INTERIM REPORT

(Small Amount Credit Contracts Only)

Introduction

The Finance Industry Delegation (Delegation), presenting the concerns of 189 lending outlets and 81 Australian Credit Licensees, recognises the constructive approach taken by the Review Panel in publishing an "Interim Report", listing policy options to assist the progression of the SACC Review.

Having something in writing concerning the issues for which the Review Panel has yet to arrive at a final recommendation, that all stakeholders can consider and comment on before the Review Panel presents its final report to Minister O'Dwyer, could be very useful in assisting the progress of the current conversation.

Assisting progress

One of the challenges for the Review Panel, going forward, is to finalise recommendations that reflect the applicable seven core Turnbull Government business and economic policies:

- Maintain industry sector viability,
- Promote Australian employment,
- Promote small business,
- Promote competition,
- Reduce business red tape,
- Encourage diversity, and
- Offer consumers credit inclusion, not massive exclusion.

Unfortunately, if they were to be adopted, the combined impact of the Options included in the Interim Report <u>are in conflict</u> with all these policies.

Six adverse outcomes

If adopted, at least Options 1-3 would lead to six possible adverse outcomes:

1. The Minister would have to convince the Treasurer to find approximately $857 million, this year, to fund the not-for-profit sector's expanded loan book and $160 million for the necessary infrastructure to replace the commercial lenders, so that the not-for-profit sector could increase its involvement from its current position of providing under 2% of all SACCs.

   The not-for-profit sector would also have to alter its criteria for lending, as it currently only accepts consumers whose situation applies to less than 13.4% of the SACC market. The Review Panel is invited to revisit pages 20-24 of the Delegation's October submission, detailing the many difficulties associated with the not-for-profit sector replacing the commercial lenders.

2. ASIC would have to continue its apparent policy that has existed over the last 3 years of providing a 2-tier supervisory role - applying the existing regulatory regime to small and medium industry participants, but ignoring a select group of larger, primarily ASX-listed lenders - to ensure even 60% of consumer demand was met.

3. The loan supply vacuum being filled by illegal lenders, in particular the notorious Finks motorcycle gang, who <u>already</u> have substantial experience in lending SACCs in two states. They have substantial funds available, generated by their

other illegal activities, including providing "protection" to retailers and illegal drug manufacture and distribution.

4. The creation of a socio-economic disaster, as at least 500,000 former SACC consumers will be excluded from access to the only source of legal small amount credit available to them.
5. A substantial increase in the incidence of borrowers facing debt spirals, due to former SACC borrowers predominantly seeking loans that currently average $475, for a matter of weeks, being forced to borrow amounts in excess of $2,000 for a year or more - just to obtain any credit - or entering into a questionable drawdown model, with continuing credit limit arrangements of $2,025, which are currently being adopted by one major internet lender and not generally recognised or adopted by others in the industry sector.
6. All bricks and mortar lenders would close and the few surviving internet lenders' loan assessment and administration would all be undertaken in low cost overseas jurisdictions such as the Philippines. This providing substantial supervision challenges for ASIC - akin to those continuing to be faced by a number of USA State law enforcers who find that, in states where SACC-type loans are very restricted or banned, local loan demand is supplied by offshore companies.

Separating the compliant from the non-compliant lenders

There exists a situation where some relatively few, generally major high profile lenders, have been adopting questionable lending strategies. This situation cannot be used to justify new draconian regulation that will severely punish, not only these lenders, but also the many small, medium and large lenders who have invested significant resources and time in their commitment to adopting lending models that are compliant.

The compliant lenders have suffered business disadvantage for three years, while the few non-compliant lenders have had their way. During that time, under what appears to be a two-tier ASIC approach to enforcing the current law, the majority have also suffered increasing frustration waiting for ASIC to do something about it.

The questionable lenders are very well known for the most part and easily identified on the type of bank statements the Consumer Action Law Centre (CALC), Credit Corp and the Delegation referred to at the Melbourne and Sydney stakeholder roundtable meetings. There are no perfect solutions. However, before changing the relevant laws, it is important to carefully examine what attempts have been made to enforce the current laws.

The Delegation is aware of a number of outstanding ASIC officers that could be directed to give their attention to the non-compliant companies. This could have significant beneficial results for consumers, addressing many of the issues that have motivated critical comments concerning the industry sector that have been presented to the Review Panel. These results could be achieved without a single change to the current laws.

This supplementary submission is provided in 2 sections:

Section One - The next essential steps (page 5).

This provides a critical consideration for the Review Panel's future strategy and a number of general comments that apply to each significant section of the Interim Report. However, this is only in regard to SACCs, as the Delegation does not represent applicable lessors.

Section Two - Specific responses to the Interim Report (page 14), following the content of the Interim Report.

This includes unavoidable and very necessary comment on some of the observations presented in the Interim Report, plus specifically requested detail in regard to the Options and the Review Panel's request for further information.

SECTION ONE: The next essential steps

It is the Delegation's view that action stemming from this Interim Report must now proceed with the following in mind:

1. *Recognition of the general body of consumers*

The review process to date presents one glaring omission from the list of stakeholders, with whom the Review Panel must be expected to communicate - the actual consumers - the very consumers the current (any any future) regulatory regime is supposed to protect.

With only one exception, during similar reviews since 2003, both state and federal governments have ignored the full range of consumers in the past. It would be unfortunate if the SACC Review was to breach Prime Minister Malcolm Turnbull's various promises - to govern in a manner that reflects effective communications with those being governed.

The "exception" was created in 2006 by the Victorian Government and should not be ignored on this occasion.

The voices of all the stakeholders, some of whom are currently participating in the 2015/16 SACC review, were heard by the Victorian reviewers. A very senior bureaucrat and a senior backbencher representing the minister (now Minister for Education, Deputy Premier and, at the time of writing, Acting Premier), visited numerous lending outlets and actually spoke face to face with consumers and with small, medium and large lenders at their business premises.

With the current review's consumer input, to date, having been limited to representation from consumer advocates - who only deal with a tiny proportion of consumers who are either in financial trouble, or who are seeking an excuse to avoid their contracted financial responsibilities - then this proactive research should be considered an imperative.

The Delegation notes the statement that "*Further stakeholder engagement will occur through invitation*".

We consider the opportunity for the Review Panel to talk directly with consumers, and "ordinary lenders", to be an essential part of this invitation process.

Without such the great body of consumers will be ignored and there is a danger that the views and lending behaviour of only a select number of larger lenders will dominate the review process outcomes.

The writers of this response facilitated the Victorian visits in 2006.

There was no opportunity for stage management. The reviewers were invited to visit the lenders unannounced and talked to consumers as they came in off the street.

The Delegation would like to offer the same opportunity to the Review Panel on this occasion, including direct contact with internet consumers.

2. *Opportunity for derailment*

On the basis of the content of the Interim Report - unless this invitation is accepted, the current SACC Review is in danger of being derailed by an excessive over-reliance on the fully employed, government funded, consumer advocate views.

The consumer advocates only have the opportunity to deal with fewer than 2,000 consumers a year - in total - in an environment where the total small amount loan consumers exceed 800,000 per year, with some 500,000 borrowing SACCs. At least five of the lenders each provide relevant small loans in excess of 8,000 per month.

High profile CALC contributes substantial leadership to the consumer advocate organisations in regard to Government lobbying and is not adverse to deliberately campaigning to build consumer numbers, either to build its own client numbers, or to inflate the numbers for one or other of the external dispute resolution (EDR) schemes.

While the Delegation concedes that some consumers genuinely require consumer advocate assistance, it should not be overlooked that credit client numbers for organisations such as CALC and the Consumer and Investments Ombudsman Ltd (CIO), include a significant proportion that, in the experience of the lending community, are using their client status as a means to avoid repaying their legitimate contractual obligations.

3. ***Another opportunity for derailment***

Reliance on one significant and relatively specialised lender's views, Credit Corp, without any recognition that this company is <u>not</u> necessarily typical of the industry sector as a whole - would be extremely unfortunate. While the company boasts of several years of lending experience, the majority of competitors report only becoming aware of its activities in the last two years and only becoming aware of its payday subsidiary, Wallet Wizard, within the last 12 months.

During the period leading up to NSW adopting a capping regime, before the Commonwealth regulatory involvement, Amazing Loans and GE Finance put forward optimistic claims. One company was a relative newcomer to the industry sector and the second had the "prestige" of being an ASX listed company. In the current circumstances, their fate is worth considering.

Similar very optimistic claims made by Credit Corp during this current review must be measured by the circumstances in which those claims are made and automatic adoption of the claims as being relevant for the whole industry sector, should be carefully questioned.

This questioning should at least include consideration of the following:

(a) Has the company attempted to implement all the policy options it has advanced, for a long enough period to provide an appropriate level of confidence in that company's long term viability? This would be needed to avoid the same fate as GE, with its quick withdrawal from the small loan market within weeks of the introduction of the interest rate cap in NSW, and Amazing Loans' financial collapse 12 months later.

(b) To what extent are there opportunities for this multi-product company to cross-subsidise and cross-market their various products and services - not all of which are loans?

(c) Are the views of this company influenced by the fact that the company professes a longer term interest in SACC loans over several hundred dollars, when most of the loans that appear to be of concern to the Review Panel are for amounts less than that?

(d) Is it relevant that this company has barely had 2 years' obvious presence in the SACC market place?

(e) Are the views of this company influenced by the fact that the company offers the opportunity for borrowing for terms considerably longer than those loan terms that appear to be of concern to the Review Panel?

(f) Given that there are at least two significant regulatory options advanced in the Interim Report that are not currently part of that company's operating policy, what challenging administration and systems' changes for that company would need to be adopted and how would that company's financial viability be impacted by their inclusion in the credit regulatory regime?

(g) Has there been any opportunity to compare that company's longer term applicant selection, default rates and bad debt ratios, with those of other industry participants? Atypical information - or the lack of information for the Review Panel to consider in regard to such elements - may not support a successful general industry sector application of the company's current suggestions.

(h) Given that the suggestions come from an internet lender (only), how different is the lending environment for bricks and mortar outlets?

(i) Given that the suggestions came from a lender who boasts of a very high level of systems automation in the application process (keeping costs down), how significant is it that ASIC does not believe such automation can deliver suitable responsible lending standards and recently demanded that another high profile internet lender, Nimble, dismantle its similar highly automated system. This dismantling required the employment of 100 additional staff, presumably to undertake ASIC-approved assessment and verification procedures.

The question has to be asked - if ASIC applied its Nimble standards to Credit Corp, would Credit Corp be as enthusiastic about its suggestions to the Review Panel, in the face of significant increases in staff costs?

4. ***Unquestioning acceptance of flawed studies***

It has often been the practice of consumer advocates, academics and industry review panels to unquestioningly accept Australian credit industry studies undertaken by organisations that do not have any association with lenders, with research results that are dated, based on far too small a sample, and otherwise are fundamentally flawed. This is demonstrated in the CALC October submission to the Review Panel.

However, there are two fundamentally flawed research reports that have also featured in the Interim Report.

These have erroneously been presented as indicative of the industry sector as a whole. One report was prepared and provided by ASIC (Report 426) and the other commissioned from Digital Finance Analytics (DFA) by a group of consumer advocate/not-for-profit loan providers.

The first, ASIC Report 426, relates to data collected in August 2013 (within weeks of the SACC regime being introduced) - from a biased, unrepresentative and relatively small sample of lenders who had already been brought to the attention of ASIC and were requested to provide a specific, relatively small number of consumer files, according to certain criteria, which skewed the results.

The second, DFA's 2015 report commissioned by CALC, Good Shepherd Microfinance and the Financial Rights Legal Centre, relates to a household survey that involves attempts to analyse change by admitted extrapolation from - and comparison with - two pre-SACC regime studies that also lack appropriate foundation.

Despite the company's public statements that it had contact with 26,000 people, the company admitted that the 26,000 people related to the total number over all three studies and that there was (extensive) extrapolation and 'guestimates' involved. Add to this the total lack of known contact DFA had with relevant industry personnel and their consumers and the attempt to compare pre-SACC regime studies in 2005 and 2010 with the work claimed to have been undertaken in 2015, is evidence that this study must be considered lacking sufficient credibility.

The Delegation invites the Review Panel to revisit the highly critical analysis of these two reports, which was included in the Delegation's October 2015 submission to the Review Panel at pages 33 and 34.

The Delegation notes that, commencing September 2015, a number of Delegation supporters participated in an ASIC survey, which was presented as being an activity associated with the SACC Review.

It may be unfortunate that the Review Panel were not in a position to include data from that survey in their Interim Report Observations.

5. ***ASIC's role as a regulatory enforcer***

There is a continuing awareness that a number of the current regulatory regime elements should not be rejected as unsuccessful, and requiring replacement, without a careful analysis of ASIC's role as a regulatory enforcer.

The Delegation is concerned with regard to the content of the Interim Report's "Observation 2". As the Delegation indicated at the Sydney stakeholders' roundtable meeting, while it is agreed that ASIC enforcement must be a priority, there is an underlying issue that the Delegation encourages the Review Panel to consider.

Comment was made at the Review Panel's Sydney stakeholder roundtable meeting that the industry sector was generally disappointed there appeared to be one set of laws for the smaller or medium lender, and another for the larger - and particularly ASX listed - lending companies.

As part of that comment it was stressed that a simple consideration of a small range of bank statements collected in the approval process, by any SACC lender, quickly indicates the lender's level of support for a number of responsible lending criteria and that the Delegation was not confident that ASIC had given an appropriate level of attention to a few of the largest lenders.

In these circumstances, the Review Panel might find that a consideration of the progress of the current ASIC Capability Review could be very useful. The Delegation has provided a copy of its submission to the Capability Review as an appendix to this supplementary submission, in order to assist the Review Panel's awareness of relevant ASIC performance issues, and is pleased to note the Interim Report's comment on the priority of ASIC enforcement action.

It may well be that the lending policies of some major lenders, that were criticised by CALC and Credit Corp representatives at the Sydney stakeholders' roundtable meeting, would be significantly diminished as a source of criticism if ASIC adopted a more consistent regulatory enforcement policy.

6. ***The lending policies of the biggest lender***

At the Sydney meeting a representative from the NSW Law Council, who had been involved with a relevant class action, expressed a concern regarding the lending policies of the biggest lender, Cash Converters. This concern must be considered in the following context.

Cash Converters has adopted lending practices that are not always reflected in general industry sector practice, including lending to the lowest level (by amount) of Centrelink benefits' recipients, its approach to the maximum two loans in 90 days rebuttable presumption and certain contract structures. This behaviour has long been the focus of general industry and compliance expert concern and ASIC has never publicly acknowledged any interest in investigating the company's policies and practices.

7. ***Conflict with Government policies***

The current raft of policy recommendations by the Review Panel, if finally adopted by the Minister and her parliamentary colleagues, would conflict with seven fundamental Government policies, as listed earlier.

8. ***SACC industry sector viability***

The SACC Review began with then Minister Frydenberg announcing that one of the major objectives was to maintain a viable industry sector. The Review Panel subsequently received substantial evidence by way of written submissions from industry sector representative entities and statements at the Sydney stakeholders' roundtable meeting, which indicated that the industry sector was facing serious costs pressures, that fee and annual cost rate caps set in 2011 had remained static in contrast to significant escalation in lender operating costs, and that lender losses were not uncommon.

It is noted that the Interim Report includes a number of suggested policies that would further significantly reduce lender gross income. A number of unfounded assumptions are made, without any statistical analysis or economic modelling offered to support the particular Option. This creates a situation where it is critically important for the Review Panel to revisit the October industry segment submissions and to carefully consider the economic facts and cost detail outlined in this Supplementary Submission.

At the Sydney stakeholders' roundtable meeting, the Delegation promised to summarise the verbally presented cost and associated information and include it in this supplementary submission. The cost information presented included:

i. Cost increases experienced by lenders 2010-11 to 2014-15 for 6 typical small and medium SACC lenders located in High Street or equivalent retail premises in South Australia Victoria, New South Wales and Queensland.

	Rent %	Electricity %	Insurance %	Maintenance %	Bank fees %	Cleaning %	Security %	Wages %
Adelaide shopping mall	35.75	20.54	19.04	Included in rent	N/A	17.61	16.66	31.7
Adelaide suburban shopping strip	27.27	37.05	19.09	Included in rent	N/A	16.66	16.66	31.7
Sunshine coast	13.1	Change to solar system	Paid by another company	Paid by another company	50+	Staff	Paid by another company	37.95
Sydney city	31.74	96.47	13.8	315.1	70.34	Self/staff	Included in rent	13.27
Melbourne suburban	8.05	80.93	-8.46	467.28	70.07	Self/staff	Included in rent	14.49
Brisbane suburban	56.2	71.9	20.24	355.59	70.34	Self/staff	Included in rent	101.52

ii. Government indicators of cost increases - National Figures

Inflation (March 2011 to September 2015): Aggregate 9.86%

The following chart demonstrates the impact of inflation on permitted fees, if this had been recognised as a basis for fee adjustment.

Principal	$	20%	4%
January 2011	200	40.00	8.00
September 2015	200	43.94	8.78
January 2011	350	70.00	14.00
September 2015	350	76.90	15.38
January 2011	550	110.00	22.00
September 2015	550	120.85	24.17

Source: ABS website inflation calculator, downloaded November 2015

iii. The change in average weekly earnings is also a useful indicator of cost increases throughout the business community. The relevant figures are:

January 2011: $1,015.20

September 2015: $1,484.50

Increase: 46.2%

Source: *ABS Average Weekly Earnings Australia Report #6302.0*

iv. Finally, movements in the Aged Pension amount deserve attention, particularly because pension adjustments tend to lag behind the cost of living. The relevant figures are:

Aged Pension 20.9.10: $658.40

Aged Pension 8.11.15: $867.00

Increase: 31%

Note: increase based on CPI, all group Sydney running average.

Source: *Centrelink website and Parliament of Australia Research Report.*

We invite the Review Panel to revisit pages 19 and 20 of the Delegation's October 2015 submission and also to consider the following specific details on cost.

2016 Research: New customer acquisition costs

This survey of 22 diverse lenders, a sample representative of the industry, was conducted in week 3 of January 2016. Methodology details are provided in Appendix 1.

Putting aside the four lenders who were not chasing new business, or who were relying on the position of their premises to attract custom, costs ranged from $130 to $300 per consumer.

Lenders reported very diverse costs for acquiring a new customer/consumer, with only the large bricks and mortar lender's figure reflecting the advantages of scale.

Because of the diversity, averaging the expenditures may not be materially significant. However, the average cost reported, net of those not chasing new business, was $212.33. This is marginally higher than the average for some very high profile lenders of $187, presented by the Delegation at the Sydney stakeholders' roundtable meeting.

2016 research: Administration costs

A considerable diversity of administration cost associated with processing a first time borrower's application were reported. Significantly, amongst the internet lenders it averaged $180 and amongst the bricks and mortar lenders it averaged $110.

9. ***Bad debt costs***

The Delegation is not aware of any specific consideration being given to the costs associated with unsuccessful lending and its impact on the lender, as part of the consultation process.

The losses of four companies participating in a 10 lender case study, undertaken by the Delegation in preparation for the Sydney stakeholders' roundtable meeting (methodology details provided in Appendix 1), provide an indication of the necessary amounts that must be recovered from successful loans, in order to maintain lender viability.

Of all SACCs successfully lent by all 10 lenders in 2014-15, there was a need to recover and average of $20.64 from the gross profit of each successful loan, to cover lending losses associated with total bad debt costs.

This issue was also explored in the research undertaken for the Delegation in January 2016.

2016 Research: Bad debts

As discussed elsewhere in this submission, for the Delegation supporters, these figures are reflected in what those lenders actually charge.

Lenders were asked two questions in regard to bad debts and the responses are summarised below:

1. “*On average, how much do you lose (principal and outstanding fees) when you write off a loan?*”

For those lenders whose loan books are generally focused on the larger SACC loans, the range of average loss was from $400 to $2,500 and the averages amongst these lenders was $1,367 (with one lender unable to provide an amount and excluded).

For those lenders who generally approve loans for under $1,000, the range provided was $63 to $480, with five lenders unable to provide an amount. The average amongst the lenders who could identify an amount was $358.

The average figure amongst all the lenders was $1,011.

<u>Please note</u>: the concluding “averages” are absolutely indicative and do not represent the average of every loss suffered, as the writers did not have access to information on every loss.

2. “*What percentage of your total loans are you currently writing off?*”

The percentages provided by the larger loan lender segment were:

2%; 5.5%; 6%; 7%; 8%; 9%; 10%; 10%; 14%; 15%; 30%.

The percentages provided by the smaller loan lender segment were:

3.9%; 5%; 5%; 5%; 5%; 5.5%; 7%; 8%; 10%; 12%; 14%.

10. ***Supporting small and medium business***

The current Minister O’Dwyer, in her associated role as Minister for Small Business, has adopted the continuing Government policies of promoting and protecting the Australian small and medium business sector.

As the Delegation’s January 2016 industry research findings (outlined later in this submission) indicate - in response to each of the Interim Report’s suggested policy options considered below - adoption of the policies will significantly discourage small and medium business from continuing as lenders in the SACC industry sector.

These findings are also disturbingly ironic given that, as a whole, it is this lender segment that has most vigorously devoted the resources and time to being regulatory compliant.

11. ***Promoting competition***

The joint impact of cost pressures and the adoption of regulation, such as that listed in the Interim Report, will contradict Government policy by delivering the SACC industry sector to 3 or 4 major lenders - owned and or funded by offshore companies with their loan management operations conducted from the Philippines, or similar low cost jurisdiction.

Bill Shorten, the Minister at the time, at a consumer advocate conference in 2010 publicly declared that he wanted a regulatory regime that reduced the number of lenders to 12 to 14 - for easy ASIC regulatory control. Wholesale adoption of the Interim Report policy options will make a far greater contribution to less competitive industry consolidation and the loss of 2,400 full and part time Australian jobs.

The Delegation is unable to speculate on the possible difficulties for ASIC in attempting to supervise offshore operational lending companies, but we are mindful of the dilemmas experienced by regulatory authorities faced with this situation in the USA.

12. ***Maintaining financial inclusion***

Over the last six years, since the early COAG meeting endorsing the Commonwealth takeover of the regulation of SACCs, the various relevant Commonwealth Ministers have also acknowledged the importance of financial inclusion. Adopting a new regulatory regime that effectively abolishes small and medium company SACC lenders destroys the financial viability of lending via the existing 320 bricks and mortar lending outlets nationally, with their greater opportunity for effective, personal assessment of applicants and the building of compliance-useful consumer/lender relationships.

A consideration of the CoreData survey results and information contained in the publicly listed lenders' annual reports, shows that bricks and mortar outlets still provide in excess of 70% of all SACCs, being the consumer-preferred method of borrowing.

Adopting the Options' regime will encourage internet-only lending, by a small number of companies that have not all demonstrated consistent commitment to compliance in the past. It will also introduce an era of a paucity of SACC loans to meet legitimate consumer demand.

This <u>does not</u> assist responsible financial inclusion.

While there are consumer advocates who have encouraged the Review Panel to recommend the adoption of a new regulatory regime that they admit effectively abolishes SACCs, the Review Panel would be aware that there have not been any Ministerial plans announced to provide further loan funding to the not-for-profit sectors' NILS and LILS schemes. That means the small number of lending companies that could possibly be left will continue to have access to over 98% of consumers, with consumers seeking financial inclusion being forced to deal with the handful of internet lending companies - or with illegal and/or unregulated sources of funds.

In the face of Government policy encouraging competition, there are already concerns expressed about the lack of competition in the SACC market place and the above scenario does not encourage a more optimistic view concerning competition. As discussed later in this supplementary submission, competition will further deteriorate if the Interim Report's policy option concerning 2 previous SACCs in the last 90 days is adopted. This alone will lead to these few surviving companies effectively locking in their consumers in regard to repeat business.

13. ***Proper responsible lending***

Since approximately August 2014, ASIC has repeatedly expressed its concerns about attempts to implement fully automated systems.

ASIC has stated that it has yet to see such a system deliver responsible lending levels in accordance with legislative expectation. Industry IT experts agree that such an achievement is not possible. Some form of personal enquiry and/or verification contact is always required to meet legislative, Australian Federal Court and ASIC Regulatory Guide expectations.

There has not been any Ministerial statement contradicting the Court's and ASIC's concerns and the Delegation therefore assumes that it is Government policy to maintain responsible lending standards - as envisaged in the National Consumer Credit Protection Act (the Credit Act). It is noted that, when in Opposition, the current Government unanimously supported the passing of this legislation without amendment.

However, adoption of a regulatory regime with all the possible options included in the Interim Report will create such large cost pressures on the few lenders left in the industry sector, due to reduced gross income, that it must be expected there will be further attempts to introduce fully automated loan application assessment systems.

14. ***Change for the worst***

Almost all of the suggested options included in the Interim Report have the propensity to dramatically change the SACC landscape in Australia - and not for the better.

The issues are not necessarily direct vote winners or losers but, should the supply of SACCs dry up, the impact of unwise policy options being recommended to the Minister - and implemented -

- could have major social engineering repercussions;
- could provide a major dilemma for the not-for-profit lending sector, as it turns away hundreds of thousands of consumers;
- could provide unbelievable lending expansion opportunities for the ruthless Finks outlaw motor cycle gang, that has considerable experience with lending small amounts of money and almost unlimited amounts of drug manufacturing and retailing generated profits to lend; and/or
- could eventually provide huge financial bonuses to the very few companies that survive, most of whom being the primary targets for the anti-compliance allegations noted in the Interim Report, when all the small to medium bricks and mortar and other internet lenders have been forced to leave the industry sector.

The issues should not be considered from a financially comfortable, upper middle class mindset - ignoring the majority of SACC consumers - nor from an idealised philosophic stance.

SACC lending is an unavoidable part of the financial landscape in every jurisdiction around the world. Effective regulation change for the whole industry sector <u>cannot</u> be achieved by adopting proposals that are based on:

- the limited experience of one part of the industry sector;
- the adverse compliance behaviour of one or a small handful of lenders;
- outdated and inadequate reports; and
- the wishes of one stakeholder group that simply wants SACCs abolished.

SECTION TWO: Specific responses to the Interim Report

1. *Regulatory content v enforcement*

The Delegation notes that, under the subheading "*Background to the Review*", it is mentioned that the Government has asked the Review Panel "*to examine and report on the effectiveness of the law relating to small amount credit contracts (SACCs)...*"

Unfortunately, what is not included in this statement is any recognition that, when assessing effectiveness, the history of the enforcing organisation's activities must be considered. The content of the law is one thing, the effective encouragement to obey is another. To state the obvious - an existing law cannot be properly assessed for effectiveness unless its enforcement history is reviewed.

2. *Concerning "consultation"*

Under the subheading in the Interim Report, "*Consultation*", the Delegation notes the comment that:

"*Four roundtables were held with interested stakeholders to gather information, seek alternative perspectives and discuss policy issues in depth. The Panel also held bilateral meetings with financial institutions, businesses, academics, consumer groups, regulators and international bodies*".

It is noted there has been a significant omission of contact with consumers and field visits to lenders' premises.

3. *Financial inclusion*

Observation 1
One of the key outcomes of regulation in the financial sector should be the facilitation of consumers onto a path of financial inclusion rather than exclusion.

The Delegation agrees that "*regulation and consumer protection should enable consumers to access credit that they can afford and place consumers on the road to financial inclusion over time. Unaffordable finance that absorbs a large portion of a consumer's income promotes financial exclusion and can exacerbate the problems faced by vulnerable consumers*".

However, the Delegation notes:

(a) There is the issue as to what it costs to provide credit.

Consumers will be excluded if the regulatory regime imposed, and third party costs over which the lender has no control, are such as to make it financially unfeasible for the lender to continue.

(b) While the recognition of continuation of the current 20% and 4% permitted fees regime for the first SACC loan is noted, the Review Panel cannot overlook the fact that these amounts were established in early 2011. Lenders have suffered considerable lending cost increases since then, as detailed earlier in this supplementary submission.

(c) The Review Panel should be aware that the 20%, 4% regime was suggested by Cash Converters in 2010, in circumstances where other lenders and the industry's representative bodies were, with justification, seeking higher percentage amounts.

4. *Industry trends*

Further information on the following is requested:

Information on trends in the SACC and leasing industries including consumer characteristics.

The Delegation's January 2016 industry sector research reveals:

- An increase in the average amount of the loan principal of a SACC demanded by consumers.
  - In 2010-11 the SACC loan equivalent average was $275.
  - In mid-2013, the figure was $372.
  - Currently, the average is $475.

The Delegation's 2014-15 case study of 10 lenders indicated that, amongst the 10 lenders, minimum amounts offered ranged from $124 to $374 and maximum amounts ranged from $1,860 to $2,480. The lender's average amounts lent ranged from $372 to $1,735.

- Increasing difference between consumer loyalty associated with online lenders and bricks and mortar lenders.
  - Where internet lenders were reporting loyalty rates of up to 50% 3 years ago, most are now in the low teens with two exceptions, known to the Delegation, where the rates are approximately 30%.
  - By way of comparison, a number of recent surveys conducted for the Delegation showed loyalty rates for bricks and mortar outlets have always exceeded 50%, with some lenders reporting rates at and above 80%.

2016 Research response:

The general characteristics or priorities of SACC borrowers have not changed for most of the surveyed lenders. Changes of interest impacting on a minority of the survey respondents were not materially significant for the industry sector as a whole, and included:

- Three medium bricks and mortar lenders reported a lot less Centrelink recipient business, with one reporting an increase. One medium and one small bricks and mortar lender each reported "some" decrease in Centrelink recipient applicants.
- A two-outlet medium bricks and mortar lender reported an increase in the diversity of age groups.
- One lender has moved from bricks and mortar to online lending and has not observed any difference in consumer characteristics.

Given introductory comment included in the Interim Report, details were asked on both employment and male customer numbers:

1. "*Percentage of SACC consumers employed*" -

There were no material differences between the lender types, particularly internet as opposed to bricks and mortar and, while one small mobile lender and one small bricks and mortar lender reported employment levels between 20 - 29%, two internet and one small and one medium bricks and mortar lender reported levels between 40 - 49%. One small bricks and mortar lender reported 50%, the other 16 participating lenders' answers ranged from 60% to 100%.

2. “*Percentage of SACC customers who are male*” -

The proportion of male borrowers per lender was very diverse, with only mobile lender demonstrating a significantly lower proportion of male consumers (25% and 40%). One internet, one medium bricks and mortar and two small bricks and mortar lenders reported male proportions in the low 40%s, while the other 17 lenders reported proportions between 50% and 60%.

The Review Panel is invited to revisit pages 14-17 of the Delegation's October 2015 submission.

5. ***Responsible lending obligations***

Observation 2

The responsible lending obligations do not appear sufficient to prevent financial harm to consumers who use SACCs. Additional consumer protection specific to SACCs seems to be required. ASIC enforcement of the responsible lending practices of SACC providers should be a priority.

Delegation introductory comments:

(a) Primarily a very small group of major, high profile lenders have adopted lending policies encouraging this observation.

(b) 100% protection from financial harm cannot be achieved. There are consumers who are simply irresponsible, and/or who lie during the application process, and/or have little or no intention of meeting their financial obligations.

(c) As indicated earlier, presuming that additional regulatory provisions are required before considering enforcement and supervision track records may simply lead to the previously compliant lender being penalised with additional regulatory burden (enough to even force them out of the industry sector) while the previously non compliant lender continues their profit enhancing ignoring of the expected contemporary compliance standards.

The statement, “*Several stakeholders suggested that there was no need to address repeat borrowing as financial harm to consumers could be prevented by relying on the responsible lending obligations*”, requires attention:

(a) Fundamental to responsible lending is affordability - not the actual number of SACCs.

(b) The Credit Act’s current comprehensive credit assessment requirements, together with the ASIC-encouraged regime of loan approval only with an appropriate income surplus after all relevant income and expenses are considered, provides a very easily audited framework.

(c) In his other capacity as a compliance adviser and reviewer, one of the writers inspects over 1,000 consumer files a year. In his experience, it takes less than 3 minutes to inspect a consumer’s file and reach a well supported conclusion as to whether or not the lender has applied an appropriate responsible lending framework when approving the consumer’s application.

The statement, *“However, the evidence appears to suggest that reliance on responsible lending obligations alone is not sufficient”* demands the closest scrutiny.

Looking to the dot points included in the Interim Report:

- "*ASIC’s Report 426 found that rates of compliance with the responsible lending obligations are low; and...*"

This is an outdated and procedurally fundamentally flawed report. Again, please refer to pages 33 and 34 in the Delegation's initial submission for a detailed analysis of this inadequate document.

The presumption that the report is relevant to the contemporary SACC Review seriously threatens effective review outcomes.

From the Interim Report "*Some stakeholders noted that it can be difficult to understand and comply with responsible lending obligations, as they are abstract and highly principle-based. In relation to one responsible lending obligation, the Credit and Investment Ombudsman (CIO) noted:*

"*[i]t is the observation of CIO that the lending staff of SACC lenders appear to have difficulty with the concept… [T]he training material and operational guidance manuals of some SACC lenders that CIO has seen during its investigations do not appear to either address this issue adequately or do so in inappropriate ways.*"

The Delegation makes 3 observations:

1. The level of knowledge concerning responsible lending expectations amongst Delegation supporters is very high. While it is true that, from time to time, an issue may emerge encouraging enquiry from a compliance adviser, the fundamentals that apply, at least 95% of the time, are well known.

2. The level of knowledge is now substantial because of the combined effects of at least 2 years experience with the SACC/MACC regulatory regime, ASIC amendments to Regulatory Guide 209 included in periodic new versions, at least 3 relevant ASIC reports published in the last 2 years, and well publicised Federal Court decisions and ASIC administrative penalty arrangements involving non-compliant Australian credit licensees.

   The observations of the CIO staff are either dated, or the lenders under scrutiny by CIO are looking for what they hope will be considered as plausible excuses.

3. The CIO does not routinely demand copies of compliance manuals from lenders under its observation.

   None of the Delegation's supporters, or compliance clients of the writers, or clients of the 2 biggest loan management software suppliers to the industry, have ever reported being asked for their manuals by CIO staff.

   Further, the Delegation is unaware of any professional background or staff training that would inspire confidence that CIO officers were capable of making a valid assessment of the content of manuals.

The Delegation also notes the statement, "*Academics have also noted that the reliance on responsible lending obligations is not in itself sufficient*".

The Delegation notes that the paper cited is from New Zealand. The Delegation provides two comments:

(a) The paper does not include any detailed consideration of improved enforcement activity opportunities (nor has this issue been addressed by Australian academics).

(b) In the professional compliance experience of the writers, the New Zealand regulatory regime, as administered by the New Zealand Commerce Commission under the New Zealand Credit Contracts and Consumer Finance Act, has a number of very significantly different features in comparison to the Australian regime.

6. *Alleged SACC compliance inconsistency*

The Interim Report states, "…*compliance with the responsible lending obligations in the SACC industry appears to be particularly inconsistent*".

The Delegation offers the following comments:

(a) Delegation supporters demonstrate substantial consistency with their responsible lending obligations.

(b) The writers' general industry observations are that there is far less inconsistency with small and medium lenders than with four of the major lenders, including two internet lenders.

(c) This view of "particularly inconsistent" compliance appears to be largely based on the very flawed reports previously mentioned, including ASIC Report 426 and recent reports commissioned by consumer advocates.

(d) It is the Delegation's view that any inconsistency is substantially the result of ASIC's inconsistent enforcement policies and practices and very poor training opportunities adopted by some lenders, with ASIC taking little interest in the quality of training on offer.

The Interim Report refers to CIO's first submission - "*Complaints about responsible lending and unjustness make up 18.4 per cent of all complaints about SACC lenders received by the CIO. This is more than three times the number of responsible lending complaints received about providers in other sectors*".

The Delegation offers the following comments:

(a) An examination of CIO's 2015 Annual Report provides little support for the 18.4% claim in the CIO submission. 283 complaints concerning <u>both</u> SACC and MACC loans were received, with 81 found not to be substantiated. Significantly, only 37 complaints were listed under the description "inappropriate finance, including responsible lending" - for <u>all</u> loan types. On that basis, the 18.4% figure should have been presented as 2.4%.

(b) If 18.4% represented a figure that was "*more than three times the number of responsible lending complaints received about providers in other sectors*", it means that the percentage for those other sectors should be 6.13%. That means the quote included from the CIO submission must be amended to the following - "*Complaints about responsible lending and unjustness make up 2.4% of all complaints about SACC lenders received by the CIO. This is approximately 2.55 times <u>less</u> than the number of responsible lending complaints received about providers in other sectors*".

(c) Given the number of SACC consumers each year (in excess of 500,000), it must be expected that complaint numbers would be noticeable. What CIO has not provided is a comparison between the numbers of other transactions by type and the different percentages of complaints relevant to each transaction type. It is also relevant to note that the CIO appears to have failed to mention that its SACC, so called, "members" lend in excess of 2 million SACC loans a year and the theoretic 18.4% of total CIO complaints is proportionately extremely small, even if taken at face value.

(d) Most SACC lenders are "members" of CIO, under the mandatory External Dispute Resolution regulatory provisions. This makes consideration of the proportion of total relevant membership important.

(e) Despite the <u>true</u> percentage involved, the Review Panel should be aware that there are considerable opportunities for consumer assistance and encouragement to make a complaint concerning SACC loans. Consumer advocate organisations are generally eager to assist with and promote <u>any</u> complaint against the small amount credit industry.

(f) The fact that SACCs are generally repaid on a weekly or fortnightly basis enhances possible conflict numbers, as opposed to arrangements that involve monthly repayments.

(g) Exploration of the relative enthusiasm of the different consumer types to use the free services of an EDR scheme to try and avoid repayment obligations, would also have to be considered in order to give validity as to the relevance of any comparative claim.

7. ***Bright line tests***

The Delegation notes the following comment under the subheading "*Preliminary Assessment*":

"In its submission, ASIC provided evidence that rates of compliance with principle-based obligations, such as the responsible lending obligations, tend to be lower. ASIC argued for bright line tests to be used wherever possible:

[O]ur view is that a 'bright-line test' or objective rule would be a better way of preventing debt spirals… [O]ur experience to date has been that there have been fewer compliance issues in this area with objective, 'bright line' requirements".

The Delegation comments:

(a) The administrative convenience of introducing subsequent bright-line tests, beyond that of obtaining 90 days of bank statements, should not cloud a consideration of all elements of the assessment process.

(b) To assess compliance with responsible lending requirements will still require an up to 3 minute examination of a consumer's file (in the opinion of one of the writers, compliance levels based on existing regulation are very obvious and easily detected in a consumer's file), as the number of loans - or what other criteria is contemplated by the bright-line test - is only part of the picture.

(c) Debt spirals are not only created by multiple loans. A bright-line test that encourages bigger and longer loans, albeit fewer loans in number, may make its own potent contribution to creating debt spirals. The Delegation notes that the Interim Report recognises this possibility in the concluding paragraph for Option 2, "*However, in some instances, it may result in consumers taking out larger loans*". The Delegation considers the Interim Report assessment of limiting to "*some instances*" is far too conservative and underestimates the strength of consumer motivation for access to loan funds.

(d) An alternative to encouraging longer and larger loans could be the adoption of a drawdown continuing credit approach, nominating a credit limit of $2,025, as is currently used by one major internet lender.

The Delegation believes it is unlikely that most consumers under this arrangement would actually draw down this full amount. Nevertheless, there is a corresponding larger fee and charge structure and a potential total indebtedness that may not be attractive if this model was adopted on a substantial scale by the industry sector.

(e) A bright-line test that encourages lenders to lend a certain number of loans to the one consumer, just to cut out the competitors, may be a recipe for encouraging the provision of loans without genuine consumer contemporary requirements and objectives - thus bringing forward the borrowing timeline and increasing the consumer's indebtedness and risk of a debt spiral occurring.

(f) If perceived as too stringent by the consumer, bright-line tests will encourage the desperate consumer to seek illegal and unregulated sources of loans.

(g) Will ASIC be more thorough and consistent in enforcing any new bright-line tests, or will the non-compliant, generally larger companies continue to gain market advantages over the compliant companies?

(h) If *"…it is less clear that they* (90 days of bank statements) *are being fully considered when assessing a consumer's capacity to repay the SACC*", as is claimed in ASIC Report 426 - what has ASIC done to enforce this existing bright-line test since discovering this in August/September 2013, and what does this mean for enforcement expectations if new bright-line tests are introduced as a result of the SACC Review?

The Review Panel is invited to revisit the Delegation's consideration of Question 5, dot point 3 in the original Discussion Paper, at pages 43 to 46 of the Delegation's initial submission.

8. ***Repeat borrowing***

Observation 3

High levels of repeat borrowing appear to be causing consumers financial harm. The structure of the SACC cap and industry costs appears to promote repeat borrowing and the rebuttable presumptions do not appear to have limited repeat borrowing.

The Delegation's comments:

(a) Not all repeat borrowing causes consumers financial harm. The implied presumption that any repeat borrowing is untenable is ill founded. Consumer advocates see the small proportion who get into trouble with repeat borrowing, <u>not</u> the majority of repeat consumers who never need their services. Perhaps it is significant that none of the consumer advocate submissions in 2015 provided statistics associated with this Option.

(b) The possibility of unintended consequences created by curtailing all repeat borrowing must be explored. As indicated above, encouraging larger and longer loans, with the consequent increase in indebtedness for longer periods of time, may not be ideal. The opportunities created for illegal, totally unregulated lending have to be appreciated, together with the propensity for an increase in credit exclusion.

(c) As outlined in the Delegation's October 2015 submission, at pages 43 and 44 and referred to by the Delegation's representative at the Sydney stakeholders' roundtable meeting, it can actually be more costly for the consumer to take out bigger loans, for longer, than to gain access to the same amounts of total funds via a number of repeat SACCs.

(d) Some measure has to be taken of the number of repeat consumers who do get into financial difficulties, but would have done so even with only one loan.

(e) The Delegation agrees that industry costs promote a willingness on the part of some lenders to offer repeat borrowing opportunities. However, the consumer makes an application because they perceive appropriate objectives and requirements.

It must be remembered that consumers <u>must be over 18</u> to take out a loan and the vast majority are in age groups where they have been acknowledged as having the right and capacity to make fundamentally important decisions concerning employment, marriage and voting.

The Delegation notes the consistent research results obtained in the period 2006 to 2013 by Smiles Turner, which indicates consumers' total rejection of Government interference in lending at around 76%.

On what basis does the Federal Government justify controlling the consumer who wants to borrow, and who can objectively afford to borrow from the lender, by prohibiting the lender from offering repeat loans in all circumstances?

(f) Again, the Delegation agrees that industry costs promote a willingness on the part of some lenders to offer repeat borrowing opportunities. However, the costs that promote this are third party costs largely beyond the control of the lender. At the Sydney stakeholders' roundtable meeting the Delegation highlighted the considerable costs now faced by on-line lenders from Google, for their adwords service.

(g) ASIC and consumer advocates continue to encourage the sourcing of credit checks. If adopted, the possibility of new costs associated with the National Database proposal and the certainty of new ASIC costs after 1 July 2016 with the move to industry funding of ASIC, are all about to impact on lender business policies. This impact in the context of compliance with Corporations Law, which demands that companies trade in a solvent manner.

(h) It must be remembered that, where repeat borrowing does lead to financial difficulties for the consumer the Credit Act provides substantial opportunity, as outlined in Section 72, for changes in arrangement on the grounds of hardship.

(i) The Review Panel is advised that any consideration of this Option must recognise that lenders refuse substantial numbers of applications. The CoreData research indicated a 40% rejection rate. The Delegation's interviews with the random selection of 10 lenders in November 2015 indicated that the average rejection rate was 62%, with one lender reporting a rejection rate as high as 80%.

9. ***The prevalence of repeat borrowing***

The Delegation notes the Interim Report's statement under the subheading "*How prevalent is repeat borrowing?*", that *"The high levels of repeat borrowing present in Australia may suggest that the rebuttable presumptions have largely failed to achieve their objective*".

The following Delegation comments are provided:

(a) This statement may reflect the borrowing circumstances associated with Cash Converters, Nimble and some other online lenders, but is not reflective of the industry as a whole and the numerous smaller lenders in particular.

(b) The incidence of repeat borrowing in 2010 for other lenders, as revealed by Smiles Turner research, was an average of 2.34 loans per consumer, per year, for the industry as a whole. In preparation for the Sydney stakeholders' roundtable meeting a random sample of 10 small and medium lenders, who are Delegation supporters, were asked for their annual repeat borrowing figures. These were reported as follows:

- The range between lenders was 1.1 to 2.69 loans per consumer, per year.
- The average was 1.95 loans per consumer, per year.

(c) It would appear that the prevalence is associated with the few large lenders that have come to the attention of the consumer advocates. Again, there is the challenge of introducing a measure that punishes all lenders and not just the few currently ignoring their compliance obligations, when the solution is actually to consistently enforce the current law for all.

(d) The above statement from the Interim Report does not appear to have been validated by any submission to the Review Panel. The rebuttable presumptions were <u>not</u> introduced to simply limit repeat borrowing. They were introduced to enhance responsible lending when a third or subsequent loan application was presented by a consumer.

(e) The Delegation notes that the Interim Report agrees with this view, with the inclusion of the following paragraph that appears later in the report, "*The rebuttable presumptions that a SACC is unsuitable where the consumer has had two or more SACCs in the past 90 days or is in default under another SACC, were designed to limit repeat borrowing <u>while allowing consumers access to short term credit where they were able to afford it and it was not unsuitable</u>*" (our emphasis).

(f) The test is not the number of loans, but the affordability of such borrowing.

(g) This test introduces the fundamental question - are consumers with multiple loans proportionately any more likely to get into genuine financial difficulties than consumers with two or one loan?

The Delegation provides the following comments on "*the evidence provided during the consultation process*" quoted in the Interim Report by way of dot points:

"*Research by Digital Finance Analytics (DFA) indicates that the average number of SACCs taken out by consumers during the 12 month period to 20 July 2015 was 3.64 - an increase from 2.50 in 2010. DFA also found that 30 per cent of households with customers who had a SACC, had more than one SACC concurrently*."

The Delegation, the National Credit Providers' Association (NCPA) and the two major suppliers of loan management software services to the industry sector have not had one lender report that they, any member of their staff, or any of their consumers have been contacted by DFA. This involves the majority of the industry.

As included in the Interim Report, "*One large provider* (Credit Corp) *provided evidence that 64 per cent of applications they received were from consumers who had at least one other SACC in the previous 90 days, and 85 per cent of those SACCs were for terms of less than 90 days. Five per cent of the applications were from consumers who had 10 or more SACCs in the past 90 days*."

The Delegation notes that:

(a) As an on-line lender, Credit Corp is more likely to attract such applications and that the 64% of applications mentioned does not mean that 64% of applications could not afford another SACC;

(b) The Delegation also believes the 5% figure deserves attention. However, such attention is only valid if it includes a close examination as to the few lenders contributing to the 10 or more, the size of the loans, the duration of the loan terms and the success with repayments as scheduled in the various contracts.

According to the Interim Report, "*The NCPA's CoreData survey found that around 80 per cent of lenders answered yes to the following question, 'In each quarter, did you provide SACC loans to customers who have had two or more SACCs in the previous 90 days?'. The NCPA submission also noted that, in around 7 per cent of cases, an individual was advanced credit when they already had an active SACC (that is, they had concurrent SACCs).*"

The Delegation comments:

Unfortunately, the valid question - which was not subsequently asked in the CoreData survey - was, "*What were the reasons for rebutting the presumption that* *the loan applications were unsuitable?*". The Delegation notes that the answer that applies to 73% of the cases in the Delegation's research is inherent in the evidence included in the dot point - the previous loans had existed during the last 90 days, but had been repaid at the time of the subsequent application.

From the Interim Report, "*ASIC found that 54 per cent of SACCs reviewed triggered the multiple loan presumption. Of the 13 lenders selected for ASIC's survey, only one maintained files that contained evidence on how the presumptions had been rebutted.*"

The Delegation comments:

(a) The fact that, in August 2013, a biased sample of lenders who had already come to the notice of ASIC for compliance reasons, and a biased sample of consumer files associated with their loans advanced, with ASIC prescribing a non-compliance criteria for their selection, revealed a 54% triggering of the multiple loan presumption introduced just months before - is not a valid justification for the introduction of some bright-line test. This view is also supported by the fact that ASIC did not appear to comprehensively investigate whether or not the triggering was valid.

(b) The Delegation accepts that there should have been a notation as to the rebuttal on every relevant consumer file, but this was during the early days of the rebuttal regime and ASIC had not previous considered file notes as being important. Further, the fact that there were no file notes does not automatically mean the reasons for rebuttal were not considered or valid.

Concerning the Interim Report's statement, "*The proportion of consumers with multiple SACCs has increased in recent years. DFA's research showed that 12.6 per cent of consumers had more than one SACC in 2010 but by 2015 this figure had increased to 29.4 per cent of consumers*".

The Delegation comments:

Due to the apparent lack of contact with consumers and the industry, discussed earlier, the Delegation is not prepared to accept the validity of these figures.

The prevalence of repeat borrowing in other jurisdictions, referred to in the Interim Report, demonstrates a commonality of SACC borrowing in similar societies to that of Australia. The opportunity to borrow must be maintained, as with SACC-type loans in the USA states that have attempted prohibition, or significant curtailment of SACCs, Australian consumers will be forced to go offshore for their borrowing requirements. Offshore borrowing will be totally out of ASIC's control and consumer protection will no longer be available.

In this context it might be useful for the Review Panel to reflect on the challenges now faced in the several jurisdictions that outlaw certain forms of gambling in Australia. Gamblers in these states access betting companies in the Northern Territory or overseas. Media reports indicate that the prohibition states have all been unsuccessful in their attempts to control their citizens' access to these forms of gambling.

10. ***What is the harm in repeat borrowing?***

The Delegation notes the critical sentence under the subheading "What is the harm repeat borrowing?" included in the Interim Report, "*However, repeat borrowing can put some consumers on a path to financial exclusion*".

The Delegation's introductory comments are:

(a) The significant word in this section is "*some*".

(b) This message is enforced in the later statement, "*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*".

In this second statement, the word "can" (as opposed to 'does') is the critical word. In both cases, the concerns relate to a sector of consumers, <u>not all</u> multiple loan consumers. This <u>could not possibly</u> justify a blanket bright-line test.

At this point the Delegation would also like to point out that there is no academic literature successfully and objectively evidencing this statement. There have been studies presented by academics that have purported to do so, but these have been based on flawed research. They have frequently cited earlier studies that also do not pass the test as to validity. The paucity of credible research and reports in this area could be considered a disgrace in terms of Australian academic standing.

Concerning the paragraph, "*During consultation, one stakeholder provided evidence which demonstrated that 97 per cent of consumers with only one SACC spend less than 20 per cent of their income on repayments. However, once a consumer has three or more SACCs within 90 days, they are more likely to be spending more than 20 per cent of their income on repayments. For example, 34 per cent of consumers with four SACCs and 48 per cent of consumers with five SACCs were spending more than 20 per cent of their income in repayments*".

The relevant issue is not the proportion of income spent on loan repayments, but whether or not there is enough income to cover general and other living expenses and still leave a buffer for emergencies.

The Delegation notes that the Interim Report concludes this section with a statement based on Credit Corp's initial submission, "*Taking further action to reduce repeat borrowing may create regulatory incentives to align lending practices with affordable loans to the most vulnerable. Lenders would likely respond by extending the maturity of the loans, with evidence presented during consultations suggesting that longer term credit is more affordable relative to repeat use of shorter term loans*".

It should be noted that this view is <u>directly contradicted</u> by the analysis provided by the Delegation in its initial submission.

Borrowing $1,200 as a SACC, for 12 months, generates an establishment fee of $240 and monthly fees of $48, totally $576 for the year. The total fee for this longer and larger loan is $816.

However, for the borrower who simply wants $100, every month - for 12 months - pays 12 establishment fees of $20, totalling $240 and 12 monthly fees of $4, totalling $48. The combined fee for this consumer - who is not forced to borrow all the loan funds at once - is only $288.

The Delegation notes that forcing the consumer to borrow $1,200, when all they want is $100, involves a breach of the consumer's freedom of choice. It also thwarts the fundamental basis for including recognition of the consumer's requirements and objectives in the Credit Act.

The Delegation is aware that the Credit Corp statement above is compatible with Credit Corp's stated business strategy of seeking to lend larger SACC loans, of at least several hundred dollars.

11. ***Reducing the establishment fee for subsequent loans***

Option 1

Reduce the establishment fee for subsequent loans for a returning customer from 20 per cent to 10 per cent.

The Delegation notes the statement in the Interim Report derived from both the Credit Corp and CALC submissions, "*The cap on establishment fees does not appear to align with the actual expenses incurred by lenders. Several stakeholders noted that there is a lack of competition on price in the industry, with most SACC providers charging the maximum amount of establishment fees for subsequent loans even though the fee does not reflect the actual costs*".

The Delegation provides the following comments:

(a) Competition on price is never going to be achieved when the cost of compliance plus the cost of attracting the consumer, particularly for internet lenders, leaves such small margins that competing on price is impossible. The Delegation is concerned that CALC continues to ignore this absolutely fundamental business circumstance, noting that CALC representatives <u>do not</u> claim to have business experience or expertise.

(b) The "*actual costs*" include frequently overlooked elements - e.g. the cost of acquiring the business, business running costs, the cost of purchasing the funds, plus ever-increasing compliance costs.

(c) Many lenders offering repeat loans operate in an internet or other high marketing cost environment. Under the current capped permitted fee environment, profits are not earned until a number of loans have been provided to the consumer, in order to amortise costs over more than one loan.

(d) It is not a matter of a later loan being "*more profitable*", it is a matter of the first one to three loans not earning the lender any profit at all.

(e) Realistic regulatory change can only be structured on a recognition of this business reality, which was created in part by the current cap regime that does not allow lenders to charge the true cost of the first 1-3 loans.

(f) "*Lowering the permitted establishment fee for subsequent loans could resolve the misalignment between the maximum establishment fees and the actual costs incurred*" is a totally inaccurate statement. It will do no such thing. It will simply drive lenders from the market. It is also noted that the Interim Report does not contain any economic modelling or statistical analysis to support this statement.

In the example involving the $1,200 being borrowed in amounts of $100 for 12 months in Point 10 above, the combined fee for the 12 loans would be reduced by $110 to a total of $178 (just $14.66 per loan) if Option 1 was adopted.

<u>However</u> - as cost data included in this Supplementary Submission suggests, it would then <u>not</u> be economically viable for the lender to attempt the 12 loans and this clearly demonstrates the threat to the availability of SACC loans for consumers that Option 1 creates, forcing the consumer to pay more for a larger loan.

2016 research response to Option 1

In response to the Delegation's question:

"*Could you afford to continue conducting your business in Australia, as you are doing, if the 20% establishment fee was reduced to 10% for subsequent loans issued by your company (after the first SACC was issued)?*"

One mobile lender responded "*if there were no other changes at all. Just*".

All the 21 other lenders responded with a resounding "*No*".

One lender with four bricks and mortar outlets commented, "*Definitely not. Just slightly above breakeven now. There is a hidden cost called "Bad Debts".*

That cost is not really being covered at 24. We would definitely get out of micro lending if the cap went down to 10%...".

A medium sized bricks and mortar lender commented, "*No. Our running costs are barely covered by the income we receive now. We have reduced our costs to as low as we possibly can. If you take shortcuts the bad debts cost takes up the difference*".

(g) Comment that, "*The advantages of this policy option are that it ensures that the establishment fees more closely align with the actual costs incurred, and it reduces the incentive for a SACC provider to encourage consumers to take out another SACC*" is simply theoretically comfortable for industry critics - but once again is practically incorrect.

Actual costs incurred <u>will not</u> be aligned with fees and there will not be any relevant "lenders incentive" that would be impacted.

2016 research: Costs of repeat applications

The option of reducing the permitted establishment fee from 20% to 10% for the second loan application from a consumer is predicated on the assumption that it is considerably cheaper for the lender to approve the second application, compared to the first application. The lenders participating in the January research were asked 4 questions to test this assumption.

(a) "*Is it cheaper to process an application of a repeat borrower returning within 90 days?*"

15 of the 22 responding lenders replied "*No*".

(b) "*If yes, by what percentage?*"

The seven lenders who answered yes to part (a) indicated an average of 25.7%.

(c) "*Is it cheaper to process an application of a repeat borrower returning after 90 days?*"

16 of the 22 responding lenders replied "*No*".

(d) "*If yes, by what percentage?*"

The six lenders who indicated yes to part (c) indicated an average of 17.5%.

However, the above six/seven lenders are primarily regional small bricks and mortar or mobile lenders, with low overheads compared to others.

Changes in the permitted establishment fee

The option of reducing the 20% permitted establishment fee to 10% may also be predicated on the assumption that there is a significant profit margin in the first fee of 20% that could support such a reduction.

To explore this issue, the lenders were asked, "*What proportion of the current 20% permitted establishment fee do you consider to be gross profit?*"

The lenders' responses indicated that none of the internet lenders earned some material contribution to gross profit from the 20% permitted fee, neither did the bigger bricks and mortar lenders, but 12 of the 22 earned some small material contribution to gross profit - primarily being the small bricks and mortar lenders.

For those who did consider that the 20% fee made some material contribution to gross profits, the average proportion of the fee contributing was assessed at 40.6% - or 8.1% of the adjusted credit amount charged to the consumer - meaning that 11.9% of the adjusted credit amount charged as part of the permitted establishment fee covers costs, leaving those lenders losing 1.9% of the adjusted credit amount if the 10% option was to be adopted.

For all lenders participating in the research, after averaging the proportion, the percentage of the adjusted credit amount charged to the consumer that might constitute a contribution to gross profit was 4.28%. That means the average loss created by adopting the 10% fee would be 5.72% of the adjusted credit amount.

For the 10 larger lenders who participated in the research and who currently do not derive any contribution to gross profit from the 20% establishment fee, the introduction of the 10% option would provide a spectre of huge losses, because every subsequent loan provided to a returning consumer would generate 10% of the adjusted credit amount loss.

Such a penalty is contrary to two business concepts:

1. Companies provide good and honest service in the hope that the consumer will come back to them when they require the same product or service again. No business can grow, or afford to continue, by having to constantly acquire only new customers.
2. This penalty ignores a very positive and important consumer protection/ responsible lending opportunity - particularly in the bricks and mortar and mobile lending environment - where lenders get to know their repeat customers well. This enhances responsible assessments and responsible repayment attitudes.

The Interim Report statement ignores these facts:

(h) First, the legislation requires that, after every 90 days, a new complete assessment must be undertaken (notwithstanding that it is a repeat application) (Section 128, Credit Act).

Secondly, when looked at carefully, the legislation demands substantial assessment, even for the repeat applications within 90 days since the last assessment. A compliant lender faces responsible lending obligations that barely differ between a repeat application (at any time) and a new consumer application.

Thirdly, as one Delegation supporter explained, "*a consumer's financial situation can change momentarily... Relying on an assessment done yesterday can be hazardous - let alone one nearly 3 months old*".

(i) In this context it is useful to compare the very small difference between the mandated duties of a lender when undertaking an assessment and establishing a loan for a first time applicant and, provided the lender is appropriately compliant, the duties that will need to be fulfilled when that consumer returns for a second loan - even within the 90 days.

Mandated requirements - Credit Act and Code	**First application**	**Subsequent applications**
Present Government warning statement re. SACCs	X	X
Provide Credit Guide	X	X
Enquire re. applicant's requirements and objectives	X	X
Obtain applicant's financial information	X	X

Verify applicant's financial information	X	X
Obtain applicant's bank statements covering immediately preceding 90 days	X	X
Seek information concerning past and current small amount credit contracts	X	X
Check relevance and calculate protected earnings amount for Centrelink recipients	X	X
Assess application for unsuitability	X	X
Provide Information Statement	X	X
Provide pre-contractual disclosure	X	X
Complete and check contract	X	X
Explain contract content to consumer	X	X
Check if consumer has any questions	X	X
Create and execute loan account for contract	X	X
Enquire if consumer wants to take contract to legal adviser	X	X
Provide copy of contract to consumer	X	X
Drawdown and disburse loan funds	X	X
Create consumer file, including notation and documentation providing comprehensive explanation for approval decision and an opportunity to provide the consumer with an assessment report	X	X
Mandated requirements - other Acts		
Obtain and verify identity of applicant (Anti-Money Laundering and Counter-Terrorism Financing Act - AMLCTF)	X	
Obtain applicant's approval for AMLCTF disclosure	X	X
Obtain applicant's privacy consent (Privacy Act)	X	
Obtain consent for email communications (Electronic Transactions Act)	X	
Obtain permission for communications under the Spam Act	X	
Retain documentary evidence of all steps (all Acts)	X	X

Note: the four activities not required for subsequent loans are dependent on the content of the previous permission document covering later loans and do not involved the Credit Act.

The Interim Report states, "*Given the harm associated with loan repayments absorbing a high portion of a SACC borrower's income, the Panel considers that increasing the establishment fee on initial loans from 20 per cent is likely to cause significant consumer detriment and is not a viable option*".

Delegation comment:

That means the Interim Report does not provide any opportunity to recover real costs associated with establishing a loan even if, as many do, the costs exceed the 20% amount. This circumstance must not be forgotten in the context of the increasing costs faced by lenders, discussed elsewhere in this supplementary submission, or when considering support for Options in the Interim Report that will reduce lender gross income and/or increase lender costs.

12. ***Interim Report misunderstands data***

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.

Again, there appears to be a misunderstanding in the Interim Report, concerning the extent of multiple borrowing.

A CoreData question that asked for lender "attitudes" only has been interpreted as providing an answer reflecting current actual lender practises.

As a result, the Review Panel may have come to an unfounded view as to the extent of multiple borrowing.

Please note - current legislation **already prohibits** unsuitable multiple borrowing (Section 131) in that, in the Delegation's view, existing loan repayments are part of the mandatory consumer living expenses that must be taken into account when assessing whether or not an application for a SACC is unsuitable.

Any multiple borrowing is clearly reflected on bank statements associated with consumers who have participated and this makes it very easy for ASIC to identify any lender that should be interviewed.

It may be useful to consider whether or not multiple borrowing is increasing.

2016 Research and multiple borrowing

The lenders were asked, "*Do you think the incidence of repeat borrowing, per average customer, has increased since July 2013?*"

One small internet lender and one medium bricks and mortar lender responded "*Yes*", with the latter explaining that the company had reduced the term of the loans offered and this had encouraged customers to return in greater numbers. All other 21 lenders reported "*No*".

Again, the issue of multiple loans, at any one time, must be considered with a focus on the relatively few larger companies that are most involved and most often the target of criticism, without assuming that their lending models are common to all in the industry.

13. ***Two loans+ legitimacy***

The Delegation asks the Review Panel to recognise that the suggested Option 2 overlooks a very fundamental and frequently occurring circumstance.

(a) There may be two SACCs in the past 90 days, but by the time of the application for the third SACC, one or both of these loans may have been successfully repaid.

(b) The existence or not of the two loans in the past 90 days is not the important determinant. The determinant is whether or not the consumer can afford to repay the third or subsequent loan. To ignore this determinant is to ignore factors such as the existing two loans being very small, in contrast to one very large existing loan, and the varying differences when assessing consumers' expenditure and income such that, after recognising living expenses and the repayment of existing loans, one consumer may have a small amount of discretionary income, while another may have much greater flexibility.

(c) In encouraging the larger loan, such an option places excessive amounts of cash in the consumer's wallet and, given the propensity of people to spend the cash they have on hand, encouraging expenditure that was not required when the consumer lodged their application.

(d) Encouraging larger loans than required places the consumer in a situation where they incur higher repayment amounts (principal and fees), for longer periods than would otherwise have been the case with the short, small loans.

(e) Implementation of the option will distort consumer choice, by denying a third loan to a consumer who can legitimately afford it and by prescribing a regulatory situation where consumers wanting finance will have to seek larger amounts than their initially perceived requirements and objectives would justify. The latter absolutely contradicts Chapter 3, Part 3-2, Division 3 of the Credit Act.

The Delegation has another general concern with regard to this Option - What period of time would be required to be recognised by the lender between an application for a first loan, for the next application or applications to be considered an application for a repeat loan?

14. ***Specific Delegation concerns***

The Delegation notes the introductory sentence and dot points under this subsection and provides the following comments:

In relation to "*The evidence presented during consultation appears to indicate that:*

- *it is very common for the repeat borrowing rebuttable presumption to be triggered*;"

Delegation's comment:

It should be noted that the gateway for triggering the presumption is extremely broad and simple. However, this "triggering" is not the issue. The issue is whether or not the presumption has been legitimately rebutted.

- "*the repeat borrowing rebuttable presumption is generally rebutted with limited evidence as to why the presumption has been rebutted;*"

Delegation's comment:

Such an assessment cannot be supported for general application when only two sources of comment are available to claim as evidence - CALC with its focus on the small minority of consumers who do face genuine financial trouble or are looking for an excuse to avoid their loan obligations, and Credit Corp, which has appropriately identified that bank statements clearly indicate suspect multiple lending, but fails to emphasise that these unsatisfactory bank statements clearly refer only to a handful of repeat offending lenders. It is also noted that Credit Corp has not undertaken any comparative analysis of the industry as a whole, nor had access to competitors' consumer files.

- "*the regulatory costs of properly considering whether to rebut the presumption are high; and*"

Delegation's comment:

This statement cannot be supported. In the substantial compliance review experience on the part of one of the writers - bank statements clearly identify the potential offenders and, once opened, it takes less than 90 seconds to assess a consumer's file for the legitimacy of the rebuttal of the presumption. There is no reason to doubt that an ASIC audit officer would need any more time to make a similar assessment.

Lenders should easily be able to legitimately consider the issue of rebuttal as an integral part of the assessment process.

The compliant Delegation supporters simply have this issue built into their assessment policies and procedures. The issues that determine rebuttal are fundamental to the general responsible lending obligations that apply to all assessments, so there isn't any extra regulatory cost.

We remind the Review Panel that, contrary to unfounded assertions constantly made by consumer advocates - lenders do not deliberately lend to consumers who do not have any chance of repaying their loan.

- "*SACCs provided to consumers who trigger the rebuttable presumption tend to become unaffordable.*"

Delegation's comment:

This statement lacks the necessary evidentiary detail on which to base a policy recommendation.

The facts are that most multiple borrowers proceed to satisfactorily pay off their loans. This is supported by research undertaken for the Delegation, one of the writers' observations of numerous consumer files for many lenders and the fundamental fact that lenders who adopt a repeat loan policy continue to offer repeat loans year after year.

If a significant number of the loans had become “unaffordable”, the lenders would not have recovered their loan principal and operating costs, and would no longer be lending.

In regard to Option 2, the Delegation believes that it is very important for the Review Panel not to overlook the content of the 56 page ASIC Regulatory Guide 209. The detail and explanation included in this Regulatory Guide clearly demonstrates why affordability is the test and the actual number of loans is irrelevant.

The 10 lenders in the November 2015 case study were asked to respond to the following question:

"*What would be the impact on your company's business if there was no rebuttal on the presumption re. two SACCs in the last 90 days creating substantial hardship if another SACC loan was approved, i.e. your company was prohibited from lending another SACC?*"

The answers were:

- Cease lending 5
- Serious impact 2
- Minimal impact 1
- Not applicable 2

This issue was also explored in the January 2016 research.

2016 research response to Option 2

In response to the Delegation’s question:

“*Could you continue in business in Australia, as you are currently doing, if the rebuttable presumption was removed so that no third loan could be issued to anyone who had two SACC loans in the preceding 90 days?*”

All 11 large and medium lenders, regardless of lending model, answered “*No*”.

Three small lenders and one mobile lender answered “*No*”.

Two small bricks and mortar lenders indicated “*Possibly no*” or “*It would be very difficult*”.

One mobile lender and three small bricks and mortar lenders indicated that they had a policy of not offering a third loan.

Two smaller lenders indicated "*Yes*".

15. ***The protected earnings concept***

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.

The Delegation notes:

(a) This Option is included in the Interim Report without the justification of economic analysis or economic modelling. This is most unfortunate because, if such an option proceeds further, this omission has to be addressed in the Regulation Impact Statement.

(b) It is also noted that, to the extent that Credit Corp's views were considered to support such an option being included in the Interim Report, the company told the Review Panel at the Sydney roundtable stakeholders' meeting that it aims to lend to consumers on a minimum or average of $60,000 per year income.

This level of income allows considerable opportunity to lend in such regulatory circumstances, while prohibiting loans to lower income earners - that are not part of the Credit Corp business plan.

(c) These income levels do not represent those of the majority of the relevant consumers under consideration by the Review Panel. That means the adoption of such policies would have the effect of directly contradicting concerns for credit inclusion and/or would encourage substantial borrowing from unregulated sources.

(d) With this in mind, the Delegation sought industry analysis concerning the economic feasibility of such a proposal.

2016 Research response to Option 3

In response to the Delegation's question:

"*Could you continue in business in Australia, as you currently do, if the 10% of net, after tax, income for all SACC repayments was applied to all consumers?*"

21 lenders responded "*No*".

One mobile lender responded "*Possibly not*".

(e) Again, the policy option offered would seriously impact on most relevant consumers, when only a minority face problems associated with a debt spiral.

(f) Such a policy option also ignores the many other reasons consumers end up facing a debt spiral. These are relevant, no matter what proportion of the consumer's net income is being allocated to debt repayment.

The Delegation notes that the Interim Report was unable to provide definitive evidence supporting these policy options. It is to be hoped that appropriate quantitative consumer research will be undertaken by the Review Panel, before these policy options proceed any further.

Further information on the following is requested:

- *Is policy option 2 or policy option 3 more effective at improving consumer outcomes? Please consider the cost and benefit of both options including the effect on competition, fairness, innovation, efficiency, access to finance, regulatory compliance costs and consumer protection.*
- *In relation to policy option 3, what percentage cap on repayments, relative to income amount, would be most appropriate to promote financial inclusion?*
- *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?*
- *In relation to policy option 3, would a higher percentage of income, applied to the consumer's net income, subtracting lease repayments and other SACC or lease payments, be more appropriate? Are providers able to ascertain these figures?*

<u>Concerning dot point one</u>:

The Delegation does not have any confidence that either Option 2 or Option 3 would improve consumer outcomes. In response to the specific questions asked:

(a) The cost of both options is different for different segments of the industry sector.

(b) Option one only impacts on lenders who are dependent on a repeat business policy involving the consumer having a number of loans during any one time period.

However, Option 2 impacts across the whole industry sector.

(c) That means the "cost" of Option 2 will be greater, because its implementation will lead to a far greater impact on competition as more substantial numbers of lenders exit the SACC industry sector.

(d) Both options will have a "cost" dependent on the consumers' propensity to seek alternative loans from unregulated illegal lenders.

(e) Fairness will be negated because all lenders, including those currently compliant and operating without lending to multiple SACC borrowers, as well as those adopting the criticised multi-loan lending policy, will be negatively and significantly impacted by both policy options.

The Delegation's January 2016 industry research indicated similar numbers - for both types of lender - would leave the SACC industry sector. That means potential unemployment for the lender, unemployment for their staff and the complete loss of any sale value for their businesses. In the context of the Turnbull Government's small business policies, it may be appropriate to note that 82% of all SACC lenders are family businesses with staff, and 74% have mortgaged their house to finance the business.

(f) Innovation, already nearly totally stymied, will be completely prohibited. Innovation is costly. Lenders, many already struggling to break even due to the cost pressures explained to the Review Panel by the Delegation at the Sydney stakeholders' roundtable meeting and outlined earlier in this Supplementary Submission, will not earn enough to give any thought to innovation.

(g) Efficiency is said to be encouraged due to the substantially lower gross income levels permitted under both options. However, there is a point at which there are no further opportunities to introduce more efficient methods. All but 2 of the lenders participating in the Delegation's January 2016 industry sector case study reported that they have already reached this point.

(h) For the lender seeking wholesale funds - all sources of access to finance will be discouraged due to the considerably lower interest rates lenders will be able to offer for wholesale funds.

For the consumer - there will be a substantial diminution in the availability of loans from their existing lender, or from any lender in the industry sector. There is a possibility of a socio-economic disaster with the adoption of either or both of the policy proposals.

(i) Regulatory compliance costs - these will include professional adviser fees for amendments to the mandatory compliance manuals, management and staff training and the introduction of greater management responsibility.

(j) Consumer protection - an unknown, given the unexplored propensity to borrow from illegal lenders and no indication as to whether or not ASIC is going to continue to apply its two-tier, or two levels of compliance expectation, approach to the industry sector.

There is also the policy issue as to whether or not creating wholesale exclusion, in order to attempt to stop a negative impact on a minority of consumers, constitutes "protection" - or discrimination for many and a clumsy effort at social engineering.

<u>Concerning dot point two</u>:

(a) Such a percentage cannot be indicated because springing this previously undiscussed policy concept, concerning the 10%, on the industry just two days before Christmas, plus the substantial number of lenders who take holidays during the first 2 weeks of January, has not allowed appropriate and essential comprehensive economic modelling and its associated consumer research to be conducted for this supplementary submission.

(b) The Review Panel will recall that the question included in the initial discussion paper only related to extending the existing Centrelink recipient's 20% of gross income legislation to other consumers.

The Delegation responded by suggesting that, for consistency, all pensioners should come under the 20% cap (*80% protected earnings).

Neither Treasury, nor any other supporter of the protected earnings concept, has done any research into the economics or consumer impact associated with any percentage amount, to which the Delegation can refer.

(Please note, dot points 3 and 4 are outside the mandate of the Delegation)

16. ***Default fees***

Observation 4

The limit on the amount that a SACC provider can recover in the event of default is an important safeguard for consumers. However, in some circumstances, the fees charged on default appear to be charged in a manner that significantly disadvantages vulnerable consumers.

The Delegation makes the general comment that not all lenders face the same default costs. This is significant because of the Federal Court considerations, various State Tribunal considerations and ASIC's preference for default fees and charges to reflect actual costs.

The Delegation specifically comments on the following.

"*Submissions noted that some SACC providers, in charging default fees:*"

Delegation comment:

The inclusion of the word "*some*" is highly relevant.

- "*seek to maximise their return;*
- *charge fees at levels that do not appear to reflect the actual costs incurred by the SACC provider; and/or*"

Delegation comment:

Compliant lenders are aware of the Victorian Tribunal decisions, Federal Court judiciary comments and ASIC preferences for default fees to reflect actual costs.

A 2014-15 analysis of Delegation supporter default fees and charges indicated that almost all supporters attempted to adopt default fees and charges that were highly referable to actual costs incurred.

- "*unnecessarily increase the cost to the consumer given that the consumer may ultimately repay the loan*."

Delegation comment:

Ultimate repayment of the loan is not a justification for claiming the extra cost to the consumer, of default fees, is "unnecessary". The Commonwealth ATO understands this - charging interest on unpaid taxes, despite their ultimate payment. At least in part, this reflects the Commonwealth being denied the use of the money for a period after it was due. A similar opportunity cost faces lenders. It is created by the defaulting consumer and it is only equitable that the party to the loan responsible for their creation should bear the cost.

This analysis was supplemented by the January 2016 research:

2016 Research: Default administration costs

Participating lenders were asked two questions in this regard and the lenders' responses are presented below.

"*What does it cost you to administer a first default?*"

The range indicated was between $7.50 and $100, with 14 lenders, including all the larger lenders, indicating amounts between $25 and $50. The average amount was $35.20.

"*What does it cost you to administer a second default?*"

The range indicated was between $5 and $100 and varied greatly for all types of lender. The average amount was $36.18.

The Delegation notes that almost all its supporters charge default fees of $35 or less. It would appear that approximately 40% of Delegation supporters are losing money on their default costs.

17. ***Default window***

Option 4

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

The Delegation provides the following comments:

(a) Option 4 essentially means a rewriting of every SACC contract and providing a repayment holiday for consumers.

(b) The implementation of such an option would entail amending a number of provisions in the Credit Act to accommodate the adjusted 30 day time limit before the commencement of recovery action (Section 88 of the National Credit Code), the issuing of the Regulation Forms 11A and 12A and associated amendment of Section 87 of the Code, and the issuing of the Sections 6Q and 21D notices under the Privacy Act.

(c) The introduction of such a default window obviously extends the time of possible default and the longer consumer defaults remain unpaid, the more the industry sector experiences a higher proportion of ultimate bad debts.

(d) The policy option ignores fundamental contract law - the right of contractual parties to expect and demand that the other party will adhere to the agreement into which he or she has willingly and legally entered.

(e) The length of time a default continues does not erase the administrative costs associated with the default. They emerge at the time of the default (bank and direct debit facilitation company fees) and from the day after, as the lender commences the various mandated activities associated with the range of relevant notices. Some of these have to be undertaken during the first week or fortnight after the default which, for many SACCs, means during the proposed option period.

(f) In other words, costs will be incurred under the current Credit and Privacy Acts and under the current Credit Regulations during the suggested “window” (period of grace).

Significantly, the Interim Report expresses this when it states, “*…implementing option 4 would mean that any steps taken by the SACC provider to remedy the default during the no default fee window would not be recoverable*”.

Adopting this Option would result in all lenders losing money on default administration.

(g) For those loans with a monthly repayment cycle, if adopted, this Option would provide a considerable period of inaction, with the consequent concern that the lender would face the increasing possibility of the default never being repaired and/or a lengthier loss of opportunity to relend funds due and payable. The Review Panel could expect a consequent distortion in the market, with lenders preferring weekly repayments only.

(h) Loan management software providers will face the difficulties of providing for public holidays and weekends, allowing for the possibility of a second repayment default occurring before action can commence on the earlier repayment default, plus the calculation challenges associated with a monthly repayment actually being 4.33 weeks.

The Delegation emphasises a number of the steps following default are <u>currently mandatory</u>. In addition, significant amendment to the existing Section 65 of the Credit Act would have to be introduced.

18. ***Default fee repayment amount cap***

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).

Option 5 introduces a number of issues for Delegation comment:

(a) To argue that “*Option 5 may encourage SACC providers to take steps which are more effective in having a default remedied*” is hard to accommodate, given lenders already have a fundamental interest in getting a default remedied.

Surviving as a lender is determined by the success in getting the loans repaid as contracted.

(b) To argue that "*The intent of the supplementary cap would be to set it at a level that is equal to the reasonable costs of recovery*" is to require that a substantial study be undertaken to determine what these reasonable costs are for all lender types, and to include a table in the adopted policy initiative that indicated the various "*reasonable costs*" applying - and to which type of lender.

(c) To assist in an assessment of this Option, it may be useful to note that, amongst the 10 lenders participating in the Delegation's 2016 case study, the default fees varied from $20 to $40, demonstrating a large variation in actual costs faced by the various lenders.

(d) Costs of "*taking remedial action (for example, by automatically sending a text)*" are not always assessed easily and are often not standard as between lenders. Various facilitators charge various fees to send texts. In addition there is considerable variation in the value of texts. Some facilitators allow an unread text to stay on their system a matter of minutes, others up to 3 days. None are known to allow retrieval for a period longer than that.

(e) Adoption of this Option 5 would see numerous loan terms extended. This would attract further permitted monthly fees of 4%.

(f) Introducing this Option would create the need for costly lender loan management software.

(g) Seeking to impose a minimal amount for each repayment of a default fee may act as an incentive for consumers to be relaxed about defaulting.

2016 Research response to Option 5

The response from the lenders participating in the Delegation's research strongly supports further exploration of this response with the industry sector.

In response to the Delegation's question:

"*How significant would it be for you if a new law was introduced that capped the maximum default and other fees you would recover, at $10 per week?*"

20 lenders - including all internet, small and medium bricks and mortar lenders - indicated that it would be "*Significant*", or "*Very significant*" (and negative).

One mobile lender said that it would be "*OK*".

The biggest bricks and mortar lender indicated "*Not significant*".

19. ***Calculating default fees***

Option 6

Cap default fees as a percentage of the amount outstanding on the SACC.

The Delegation has a number of concerns with this Option.

1. Such a policy would encourage lenders to move default costs into recovery costs that are simply required to be "reasonable", as prescribed in ASIC's Regulatory Guide 96 concerning debt recovery.
2. Implementation would mean that consumers could take advantage of the fact that, towards the end of a loan term, the amount outstanding would create a default fee that was simply not worth chasing by the lender.
3. To state that "*Option 6 takes into account that the loss to the SACC provider on default is linked with the amount outstanding and that the consumer should be*

able to have some benefit afforded to them based on the repayments they have made" ignores the following 5 fundamentals:

(a) the fact that lender administrative costs associated with defaults are generated by the mandated actions required to move towards recovery of the loan, or to encourage the consumer to repair the default - not the amount actually outstanding. The same cost generating actions are required regardless of the amount outstanding;

(b) third party costs such as bank and direct debit company fees generated by the consumer's default, but paid in the first instance by the lender, are charged at rates that do not give any attention as to the amount in default, or the total loan amount outstanding;

(c) just because the consumer has satisfactorily repaid in the past may not be a complete justification for the lender subsidising the consumer's default at a future time. The default is still a breach of contract;

(d) as discussed in the introduction to this supplementary submission, lenders are increasing unable to ignore such costs, or part thereof, given the other cost pressures squeezing their profits; and

(e) there is the issue raised in the Interim Report, namely, "*Many of the costs incurred by lenders as a result of default appear to be fixed in nature (for example, the costs associated with contacting the consumer). Depending on the amount of credit outstanding, linking the default cap to the amount of credit outstanding could result in situations where the default cap is well below or above these fixed costs*".

Further information on the following is requested:

- *What costs do lenders incur when a consumer defaults?*
- *In relation to option 4, what are the typical payment cycles and what is the most appropriate default fee window?*
- *What is the appropriate level of the default caps under option 5 and 6? If you are a SACC provider, please also provide evidence of the actual costs that you incur as a result of a consumer's default.*

The Delegation comments - in regard to dot point one -

Costs incurred by lenders include, but may not necessarily be limited to:

(a) informal contact with the consumer;

(b) the costs of noting the consumer default in the lender's system;

(c) payment of third party fees, such as to banks and direct debit processing companies;

(d) creating the various Credit Act, Credit Regulations and Privacy Act notices;

(e) managing the distribution of these notices in accordance with the time limits prescribed in the relevant legislation;

(f) sending these notices to the consumer;

(g) management and staff time dealing with any consumer response/s;

(h) adjusting records and/or the system when the dishonour is repaired; and

(i) repeated reviews of the consumer's file, prior to commencing recovery action.

In this context it may be useful to note the consideration of actual default costs included on page 33 of this Supplementary Submission.

In regard to dot point two:

(a) payment cycles are one, two and four weeks;

(b) while the majority of payment cycles are one or two weeks, there is no one typical repayment cycle; and

(c) repayment cycles may be changed as a result of negotiation concerning repair of the default.

2016 Research: Repayment cycles

- All 22 lenders receive weekly payments on loans.

The range was 5% to 60% of the lenders' total loans, with a mean of 40%.

- All 22 lenders receive fortnightly payments on loans.

The range was 10% to 95% of the lenders' total loans, with a mean of 50%.

- 11 of the 22 lenders responding receive monthly payments on loans.

The range was 1% to 10% of loans issued by the lender.

In relation to dot point three:

(a) there is no one appropriate default cap under policy Option 5. This must be negotiated with the individual consumer according to their individual circumstances. The process is similar to negotiating a hardship arrangement and any final decision must be affordable to the particular consumer; and

(b) there is no appropriate default cap for policy Option 6. The policy proposal is fundamentally unsound.

20. ***Repayment arrangements***

The Delegation notes the following inclusion in the Interim Report, "*Under the Credit Act, SACC providers are subject to a cap on fees where they can charge a 20 per cent upfront fee and a 4 per cent per month ongoing fee. Submissions identified that SACC providers appear to be engaging in two practices that are financially disadvantageous to consumers:*

- *the use of two-tier repayment amounts over the term of the contract (often referred to as fee-splitting), with the debt largely repaid in the early months of the contract, and nominal payments in the later months (to maximise both fee revenue and the rate at which capital is repaid); and*
- *charging monthly fees in a way that allows the lender to earn all the fees outstanding even if the SACC is repaid early*".

The Delegation considers the approach outlined in dot point one as unconscionable and, apart from exceptional circumstances agreed to as part of a hardship arrangement, considers that assessment of affordability can only be effective in advance as required under the Credit Act if, for the term of the loan, repayments are equal throughout (with the possible exception of the last payment being slightly different to allow exact repayment of some odd amount, if necessary).

The Delegation considers the approach adopted in dot point 2 breaches Section 31A of the National Credit Code. It is recognised that one major and one small legal firm may have misunderstood that this model is <u>only legal</u> in regard to MACCs.

This issue was raised in the Delegation's 10 lender case study. None of the Delegation supporters employ this illegal model for their SACC loans and only one of the lender participants was aware of three companies who had adopted this advanced collection approach.

21. ***Early repayment discount***

Observation 5

Some SACC providers do not appear to be giving consumers any benefit or discount when they make early repayments or pay back the loan in full before the due date. These practices may result from the SACC cap being based on a fee, rather than an interest rate.

The Delegation notes the following statement in the Interim Report -.

"*The effect of the monthly cap is that SACC providers do not have to give the consumer a discount for early payment. This appears inconsistent with the policy intent of the monthly cap on fees and it would not be the case if there was an interest rate cap*".

In regard to the concept of the suggested discount applying to the last received 4% permitted monthly fee (where the lender is operating a legal model, collecting the monthly fee on the monthly anniversary of the loan settlement date), the Delegation comments:

(a) The 20% permitted establishment fee relates to costs incurred at the assessment and commencement stages of the SACC loan and are not relevant for this consideration.

(b) The amounts in issue are the 4% monthly fees, which are due and payable on the monthly anniversary of the commencement of the loan.

(c) The issue as to the case would be under an interest rate model are irrelevant. The Commonwealth chose to impose a fee model and there is no relevant policy issue to which to refer, nor was one ever discussed at the numerous relevant Treasury stakeholder consultation meetings held to discuss the very prolonged development of the Credit Act and associated Regulations.

(d) Significant cost issues include the modifications to software systems required to accommodate this policy option, the administrative costs associated with the one-off calculation and the unpredictable requirement to calculate and reimburse according to the number of days left in the month subsequent to the loan repayment.

(e) The instances of early repayment of SACCs are so few that introducing such a significant policy option, in terms of cost and difficulty to implement, is unsupported.

(f) In regard to the loans of interest to the Review Panel, for the amounts that might be reimbursed on the rare occasion that an early repayment of the loan occurs, the costs and difficulties are hard to justify objectively.

(g) On the basis that the lender should not have to face costs just because the consumer effectively broke his/her contract by paying early, equitably allowing for administrative costs (for negotiating, calculating and implementing the reimbursement) to be deducted from the gross amount of reimbursement, would significantly diminish most amounts calculated.

2016 Research: Suggested difficulties associated with reimbursement of some part of the final 4% permitted monthly fee paid by the consumer

On the basis that a lender may be obliged to reimburse some part of the last 4% received (in an environment where monthly fees are collected as the legislation intended - on the monthly anniversary of the loan's establishment), the lenders were asked if they saw any difficulties with this option.

The following is a selection of the comments provided by the lenders:

"*Returns are already insufficient to achieve a fair return for lenders*".

"*System development, cash flow calculations, fees upfront calculation, manual calculation for payout enquiry, discouraging borrowers from early payout as part of their money management. Weekends and public holidays adjustments, fee not an APR, additional monthly as loan in default or extended, i.e. daily or monthly*".

"*Software development plus the cost of closing loan an additional cost burden*".

"*Calculation and exactly how would the money be refunded and who would pay the admin cost of doing it*".

"*It's a fee we need in advance to help cover costs. Increase the establishment fee to cover the cost of writing a loan and then we can discount the final fee*".

"*Difficulties with loan system calculating payout figures*".

"*Margins are bare bones as is. Wouldn't be worth lending*".

22. ***Specification of discount***

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).

It is the Delegation's view that, for the same reasons outlined in response to Observation 5, adopting Option 7 would require a highly complex regulatory formula that is not justified by either the size of the net possible reimbursement, or the relatively few times such would apply. This complexity would never deliver the desired outcome of an approach that was simple to apply, which is listed in the Interim Report.

23. ***Equal repayments***

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.

It is noted that, "*This option would prevent the situation where a SACC is largely repaid in the early months of the contract, with nominal payments in the later months (to maximise both fee revenue and the rate at which capital is repaid)*".

The Delegation agrees with this Option 8 and regards the lending model that it seeks to prohibit as unconscionable under the existing regulatory regime.

2016 Research response to Option 8

In response to the Delegation's question:

"*With your SACC loans, do consumers repay equal amounts over the term of the loan (perhaps with a minor adjustment on the last payment if necessary)?*" All 22 lenders responded - "*Yes*".

Further information on the following is requested:

- *Should lenders under a SACC be required to provide consumers with a benefit for early repayments of the balance and, if so, how should any such requirement operate? Should the same requirement apply to both the fee-splitting model and where the loan is repaid in full early?*

- *Are there circumstances in which SACC providers require consumers to make repayments for different amounts? If so, in what circumstances is this done and what is the difference in the size of repayments?*
- *To what extent do SACC providers charge fees in respect of outstanding months when a consumer repays a SACC early?*

In regard to dot point one -

The Delegation does not support a reimbursement policy option for any SACC arrangement, for the reasons detailed in response to Observation 5 listed above.

In regard to dot point two -

(a) None of the Delegation supporters are known to offer loans with repayments of different amounts (except a possible minor difference with the last repayment, to reflect exact amounts owing).

(b) Those lenders offering such loans do so for the unconscionable reasons already identified in the Interim Report.

(c) The difference in loan repayment amounts expected by one ASX-listed lender has been seen to be substantial - by as much as $100 per payment - in copies of contracts provided to the Delegation.

In regard to dot point three -

None of the Delegation supporters engages in such activity because it is illegal. The Delegation's view is that it breaches section 31A of the National Credit Code.

Thank you

The Delegation would like to thank the Treasury Secretariat for their work to date and courteous liaison with the Delegation as a representative of a significant number of lender stakeholders.

The Delegation would also like to thank the Review Panel for arranging for the Delegation to receive a copy of the Interim Report and for the opportunity to provide this response.

Attached:

Appendix One: Research Methodology

Appendix Two: Delegation submission to ASIC capability Review.

APPENDIX ONE

Finance Industry Delegation Research

November 2015 Case Study

This case study involved contact with one large, one medium and eight smaller lenders, to provide indicative information for the Sydney stakeholders' roundtable meeting.

These lenders lent a total of 89,979 SACCs in 2014-15.

Lenders were interviewed by phone and asked to complete a brief questionnaire. The critical results, reflecting the content of the Interim Report are included throughout this Supplementary Submission.

Research, week three, January 2016

So dramatic is the potential impact of a number of the options listed in the Interim Report, and given some of these options had not been canvassed before, it was resolved that specific industry sector research had to be conducted. This was to supplement the November case study undertaken for the Sydney stakeholders' roundtable meeting and the various results from earlier research quoted in the Delegation's October 2015 submission to the Review Panel.

This action was supported by a view that it was very important for the segment of the industry that did not include ASX-listed companies, to present their views to the Review Panel. Depending on the definition adopted, this segment lends 40 to 60% of all SACCs in Australia.

This presented considerable contact and processing difficulty, given the distribution timing of the Interim Report and the timetable for responses presented.

However, the included research results are so critical to the consultation process, including the assessment of the 8 listed relevant options, the issues of Review Panel interest raised in the 11 requests for information, and comment requested on the 5 observations scattered through the Interim Report, that to have presented this Supplementary Response without their inclusion would have been most unfortunate.

The additional research was conducted during the week commencing 18 January 2016. Responses were from lenders back from holidays and owning approximately half the lending outlets represented by the Delegation.

That meant participation by 22 Australian Credit Licensee supporters of the Delegation. These covered 3 major internet lending companies, 2 medium sized internet lending companies, one small internet lending company and 2 mobile services and covered one large bricks and mortar lender with numerous company outlets, 5 medium bricks and mortar lenders with a total of 9 outlets, and 9 small lenders with a total of 9 bricks and mortar outlets. The lenders involved also included members of 3 franchise groups.

Given the nature and size of the industry sector, the Delegation is confident that the number and type of participants represents an appropriate and useful sample of the non-ASX listed industry sector.

However, the results are presented in raw numbers, with the intention that they be read as indicative of the non-ASX listed industry sector as a whole. The view of the listed companies can be found in their own submissions and in the CoreData research results previously presented to the Review Panel.

APPENDIX TWO

A SUBMISSION TO THE CAPABILITY REVIEW OF ASIC

from the

FINANCE INDUSTRY DELEGATION

SCOPE: NATIONAL

Relevant ASIC Section/Division:

Deposit Takers, Credit and Insurance Stakeholders' Team

Industry sector:

Small amount, short term lenders

To the:

ASIC Capability Review Panel
C/- The Treasury
GPO Box 89
Sydney NSW 2000

Email: capabilitypanel@treasury.gov.au

Contacts: Finance Industry Delegation Co-ordinators:

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Is this submission confidential? No.

STATEMENT OF INTENT

The supporters of the Finance Industry Delegation (the Delegation) wish the Expert Panel every success. Delegation supporters, part of the small amount, short term lending industry sector, have a vested business interest in the Capability Review and its outcome succeeding, with an essential change in ASIC culture.

A capable ASIC means a compliance environment which is a competitive level playing field for all lenders, unlike the current environment, where the law abiding compliant lender is at a significant competitive disadvantage to those lenders who currently continue to get away with breaking the law.

A capable ASIC also means effective and constructive communication of all kinds between ASIC and the industry sector, to universally enhance consumer protection and compliance environment certainty for the lender, rather than the current communication environment that is fundamentally flawed.

The Delegation alleges that the current culture endemic in much of the *Deposit Takers, Credit and Insurance Stakeholders' Team* does not satisfy ASIC's stated values of "*accountability, professionalism and team work*".

Introduction

Recent helpful contact with the Review Panel's Secretariat, at the Sydney Treasury office, encouraged the Delegation to present this submission in the manner that has been adopted. This contact was supplemented by then Minister Frydenberg's media statement and Treasury website comment on the scope and purpose of the review.

Under instruction from the Treasury Secretariat, the Delegation has attempted to keep this submission as brief as possible, with the knowledge and expectation that there will be later opportunity to present the substantial supporting explanation, plus evidence associated with the 58 issues raised, during the conduct of a series of meetings and roundtables, along with the promised complementary survey-based consultation.

About the Finance Industry Delegation

The Delegation is a consortium representing and/or reporting to the owners and management of 189 bricks and mortar and internet lending sites and 6 significant suppliers of services, including loan management software, marketing advice and compliance advice to the small amount, short term lending industry sector.

Approximately 80% of supporters are self-funded small and medium enterprises, including franchisees from 4 franchise groups. The balance includes 4 of the 8 largest companies - none of which are public companies. Supporters are located in every State and the ACT and customers are located all over Australia, New Zealand and Papua New Guinea.

Four fundamentals

We invite the Expert Panel to note four fundamentals:

1. The comments included in this submission relate <u>only</u> to that part of ASIC called the *Deposit Takers, Credit and Insurance Stakeholders Team* (hereafter referred to as ASIC, for brevity). The Delegation supporters have not had any substantial contact with other areas of ASIC, and therefore it would be inappropriate to comment on those areas.
2. In ASIC Report 444, "*ASIC enforcement outcomes: January to June 2015*", dated August 2015, at page 5, ASIC stated, "*...there needs to be a fundamental shift in the culture of the financial industry - to one that focuses on achieving and rewarding good conduct and good outcomes for consumers*".

   The Delegation submits that the achievement of this fundamental shift will be impossible while the current ASIC culture continues to manifest itself in the inappropriate corporate behaviour listed in this submission.
3. The adverse comments in this submission do <u>not</u> reflect on the employment behaviour of some of the professionally impressive ASIC officers who diligently work, or have worked, as part of the *Deposit Takers, Credit and Insurance Stakeholders Team* in the various capital city offices, since the Commonwealth takeover of compliance responsibility. The Delegation is <u>very</u> confident that the challenges listed in this submission can be met following a successful Capability Review, if specific officers who various supporters of the Delegation have dealt with in recent years are provided with appropriate roles and/or appropriate authority.
4. The adverse comments are those which one of the writers personally promised to present to the Review Panel, when speaking with them at the conclusion of the Governance Institute of Australia's conference in Sydney on 26 August this year. A copy was also promised to both the immediate past and currently responsible Ministers thereafter.

How efficiently and effectively does ASIC operate to achieve its strategic objectives?

The following issues have emerged as issues of significant concern and demonstrate ASIC's inefficiency and ineffectiveness in its attempts to achieve its strategic objectives. They demonstrate ASIC's current lack of professional capability in regard to compliance enforcement and a considerable lack of understanding of the small amount, short term lending industry sector.

The issues are listed to assist the Expert Panel address a major item in the terms of reference announced by then responsible Minister Frydenberg, in his media release dated 24 July 2015, concerning the Expert Panel's terms of reference:

"*The review will consider how ASIC uses its current resources and powers to deliver its statutory objectives and assess ASIC's ability to perform as a capable and transparent regulator*".

This statement was supported by a later comment under the subheading "*Consultation*" in the media release, *"The capability review should be informed by a review of ASIC's current processes..."*. The Delegation asserts that you cannot review processes without measuring or assessing current action and outcomes.

In the absence of a discussion paper, the following subheadings reflect Minister Frydenberg's media release, Treasury website content and advice from the Treasury Secretariat.

Finance Industry Delegation concerns

1. Governance - Identification and analysis of past and immediate priorities

Concern: ASIC has demonstrated poor identification and analysis of past and immediate priorities. Without post-Capability Review change, this history may be repeated.

1.1 Failure, to date, to achieve one of ASIC's three strategic priorities - namely "*to ensure fair, orderly, transparent and efficient markets*" (ASIC's "*Corporate Plan, Focus 2015-16*", page 2 and 4).

1.2 Failure, to date, to achieve three out of the four responses to wrongdoing, or the risk of wrongdoing - namely, "*taking timely enforcement action... engaging with industry and stakeholders...* (effectively) *providing guidance to those we regulate*" (ASIC's "*Corporate Plan, Focus 2015-16*", page 5).

1.3 Failure to maintain the level of communication associated with the 2010 ASIC Roadshows and some early individual ASIC officer contact, which included genuine educational and industry understanding visits.

1.4 Failure to establish a continuing and effective rapport with the three industry sector representative entities, leaving token contact with the one entity dominated by the two large listed companies, as the only source of industry sector contribution to priority assessment. This despite published promises that "*ASIC will work with the payday lenders and industry bodies so they understand their obligations and to raise levels of compliance*".

1.5 Undertaking priority assessment based on procedurally very poor and obsolete ASIC and consumer advocate research.

1.6 Dissonance between public statement of concern and allocation of administrative and prosecution penalty.

1.7 Conduct towards lenders, and representatives of lenders, dominated by "power games" and an attempt to assert dominance regardless of continuing information collection opportunity and/or constructive outcome and/or contribution to effective prioritisation.

2. Identification of immediate and future risks

Concern: The risks may well be already entrenched, posing an even greater challenge to implement successful post-Capability Review change.

2.1 The risk that the consumer advocates and their legal centres, with all their demonstrated professional inadequacies and philosophy-driven bias, with or without Class Action lawyers, will take over compliance enforcement for publicly listed lenders such as Cash Converters.

2.2 The risk that, what some industry sector observers consider to be "sweetheart deals" between ASIC and one or more of the publicly listed companies, and two of the high profile internet lending companies, will continue. This not being available to the small and medium sized lending companies.

2.3 The risk that ASIC will continue to pursue expensive and ultimately ineffective prosecutions of atypical lenders, perceived within the industry sector as providing little relevance to most of the other lenders ASIC is attempting to supervise.

2.4 The risk that ASIC will continue to facilitate fundamentally inequitable and inconsistent decisions as to whether or not to proceed with a prosecution, simply imposing an enforceable undertaking without penalty, or coming to an arrangement without enforceable undertaking or penalty, for a favoured range of companies. This may require a re-drafting of ASIC's July 2014 "*Statement of Intent*", to clarify the criteria used in the exercise of ASIC's discretion in its choice between the several listed alternatives.

2.5 This contrary to the "*Model Litigant Rules*" included in the Attorney General's Legal Services Directions.

2.6 The risk that the current culture will continue to lead to compliance advisers being challenged by their lender clients, because "other companies (often very big ones) are doing it and getting away with it".

2.7 The risk that ASIC will continue to attempt - and substantially fail - to comprehensively enforce compliance on an industry sector it still does not understand and is still to effectively and comprehensively research in a timely manner and according to applicable best practice research methodologies.

2.8 The risk that such compliance enforcement will continue according to the latest poor research from government funded consumer advocate entities, poorly conducted and/or obsolete ASIC research, or media beat ups.

2.9 The risk that the proposed ASIC industry funded model will provide a burdensome opportunity for the smaller, compliant lender to be forced to pay for ASIC's ineffective compliance policing, particularly in regard to the listed companies and some of the larger lenders.

3. Resource prioritisation - allocation of resources

Concern: In the midst of calls for an industry funding model, which all assume to be a foregone conclusion, where is the substantial study of ASIC's current use of resources, inclusive of an appropriate rigorous audit, with transparent publication of the results?

3.1 Expensive prosecution on issues of law that have been superseded.

3.2 Selection of prosecution and administrative penalties, without regard to the consequences for borrower victims.

3.3 Allowing <u>non-legally trained officers</u> to effectively dominate ASIC lawyers in the conduct of their duties, with the subsequent imposition of questionably legal decisions and interpretations.

4. Enforcement selection and application

Concern: ASIC does not demonstrate any apparent consistency.

4.1 The implementation of two standards for compliance expectation - one for the two public companies and, generally, for two of the largest internet lenders - another for all other lenders.

4.2 The imposition of three self-funded audits on lenders, without any initial investigation or the receipt of any complaint - with an attempt to justify on the basis of allegedly not being "*confident*" that the lenders were compliant.

4.3 Distributing a list of external auditors for lenders to consider when an audit has been ordered, without widely published criteria and selection procedures of auditors and with a number on the list being former ASIC officers. This while claiming the list is not an ASIC approved list.

4.4 The imposition of a $1.128 million refund to consumers (only), with a public announcement raising consumer victim hopes in circumstances where ASIC knew, or should have known, of the company's corporate financial difficulty and that the subsequent actual repayment of only $240,000 would likely be the case.

4.5 Continuously presenting The Cash Store case and the $18.9 million fines, involving many thousands of loans, as a victory for ASIC - without explaining that it was undefended, one of the two companies (Assistive Finance Australia) no longer existed and that the other was in receivership, with very little chance of the fines ever being paid.

4.6 Conducting an indifferent prosecution against Teleloans and Finance & Loans Direct, concerning an obsolete legislative provision, while ignoring other issues associated with hundreds of allegedly non-compliant loans that were revealed by the investigation. Further, unlike other prosecutions against smaller lenders, extraordinarily agreeing to each side paying its own costs.

4.7 Engaging expensive senior and junior counsel, involving three ASIC solicitors and one solicitor or paralegal, all transported from Sydney and Brisbane and accommodated in Cairns for a 3-week trial, just to prosecute a relatively simple case against a one-store lender, involving 10 loans, in circumstances where no Enforceable Undertaking or other administrative measure was ever offered.

4.8 Not taking any personal action against the "gatekeepers" associated with larger companies (directors and responsible managers), while taking personal action against the owner of the small, one-store Cairns lender.

5. Responsiveness to emerging issues - decision making processes

Concern: How can ASIC interface successfully with emerging issues, when the decision making is based on a lack of industry sector knowledge, inadequate and/or obsolete research, and a lack of recognition of the content of the primary legislation?

5.1 Demanding the use of exact template forms in the National Consumer Credit Protection Regulations, including obsolete or irrelevant content, despite legislative and regulatory provisions allowing adaptation to suit purpose.

5.2 Despite initial concern, failing to address the rise of so called "credit repair" companies and their use of External Dispute Resolution scheme costs, to attempt to blackmail lenders into illegally removing correctly included adverse credit listings with credit reporting bodies - thus seriously threatening the utility of obtaining useful credit reports. This despite ASIC Regulatory Guide 209 recognising the utility of credit reports and individual ASIC officers and ASIC counsel expecting credit reports to be obtained as part of the lender's assessment process.

5.3 Presenting public statements and statements in letters to lenders, implying an understanding of consumer behaviour or potential behaviour, without any consumer research to support such presumptions.

5.4 Asserting consumers may be confused with regard to a lender's documentation, without proof or complaint.

5.5 The continuing presentation of ASIC Report 426, involving a study of only 13 lenders - chosen because they had negatively come to the attention of ASIC - and only 288 loans issued over 2 weeks in **August 2013**, <u>only 6 weeks</u> after the new laws commenced. These 288 loans were not randomly selected, but were selected because of a specific range of negative "*attributes*" and from over 16,000 loans offered by the 13 companies during the 2 week period. 92% of the 288 loans came from only 4 lenders. The Report was not published until **17 March 2015**.

During the interim period from 2013 until publication, relevant information from Treasury and an updated ASIC Regulatory Guide were published that provided greater clarification of relevant elements of the 2013 law for lenders to observe. However, ASIC has claimed the Report <u>currently</u> applies to the whole industry sector.

This ignores appropriate research standards and also ignores the Minister's Explanatory Memorandum at paragraph 2.109, which recognised that the manner in which Australian Credit Licensees would meet their statutory obligations would change over time "*in the light of experience and changes in the operating environment*". The report has been continuously mentioned as an indication that the entire industry needed to lift their standards.

5.6 Conducting a poorly compiled Small Amount Credit Data Survey in August/September 2015, in preparation for an ASIC submission to the statutory required SACC Review. This survey was compiled without effective communication with key loan management software service suppliers, without any contact with the three industry sector representative bodies, or without any known “road testing” of the survey before distribution. This resulted in the majority of lenders only being able to answer just 5 of the 18 questions, two of which being their company name. Only a statistically irrelevant number of lenders were able to answer any more than those 5 questions and that included a number of questions where there was more than one possible interpretation as to the nature of the answer required.

5.7 Repeated public statements and administrative conduct presuming that leasing is simply an “avoidance” business model. This ignoring the fact that leases are an entirely different form of finance to credit contracts, comprehensively regulated in the 615 page National Consumer Credit Protection Act (NCCP), inclusive of the National Credit Code and the associated 352 page NCCP Regulations, and that ASIC actually specifies the activity as an authorised and approved activity for the particular licence holder, on the ASIC-issued Australian Credit Licence.

5.8 Imposing an Enforceable Undertaking that demanded the disclosure of a cost price for the goods in a leasing model, the disclosure of which is not required by the legislation.

6. Skills, capabilities of the Commission

Concern: There are things that just have to be done better.

6.1 Inconsistency in statutory interpretation as between state offices.

6.2 Demands for prompt provision of information, followed by inordinately slow investigation and resolution processes. Practices that particularly place an unfair and unnecessary burden on small businesses.

6.3 In responding to a licensee’s request for clarification associated with an inaccurate and untested allegation of compliance breach, presenting that the response could be found in a substantially erroneous ASIC media statement, implying it was a definitive assessment of “the law”.

6.4 Demands for a lender to remove a mandatory provision in a document.

6.5 Inconsistent demands between ASIC state offices, for information and documentation concerning Australian Credit Licence applications.

7. The continuing culture of the Commission

Concern: ASIC - inequitable and/or inconsistent dominance.

7.1 Ignoring the earlier recommendations of an ASIC approved compliance auditor, formerly a senior compliance officer with ASIC, after a lengthy three-audit process, and demanding extension and substantial change at the last moment, reflecting a response to the first audit of several months before and not supported by the legislation.

7.2 Entrapment, by way of encouraging contact to assist in completing an ASIC survey.

7.3 The issuing of letters containing vague and imprecise allegations of regulatory breach, without any detail as to the legislative sections, but with a demand for the lender to admit guilt and choose from a selection of penalties. Such penalties claimed to have been applied in the past (but not necessarily for the same alleged “offence”).

7.4 Demanding that an Australian Credit Licensee adopt an entirely different business model, while admitting that none of the sections of the legislation had been breached, but that the officer simply “did not like” the current business model.

7.5 Offers of a meeting with Australian Credit Licensees under investigation being indefinitely postponed, following the licensees indicating they would be bringing their compliance adviser to the meeting.

7.6 The inclusion of inaccurate and highly prejudicial content in an ASIC media release, asserting agreement that had not been reached, implying the conclusion of an investigation process which was not concluded, and implying that named licensees had committed offences of similar magnitude or impropriety as a list of totally unconnected companies, with totally different circumstances - presumably included to maximise tabloid interest.

This process provided an opportunity for ASIC to avoid making a formal decision, thereby denying the licensees the opportunity to challenge the decision in the Administrative Appeals Tribunal.

7.7 Continuing failure to engage during an investigation, when licensees provide substantial explanation for their position, including detailed legislative analysis and precedent-based defence.

7.8 Tolerance of inaccurate and inflammatory public statements by consumer advocates and not-for-profit lending organisation representatives, with ASIC colleagues in the *Misconduct & Breach Reporting Assessment & Intelligence Stakeholder Group* determining that, despite industry sector complaint, there is no necessary “broader public benefit” justifying ASIC action - and the risk of such statements inciting public expectation that the *Deposit Takers, Credit and Insurance Stakeholders Team* will prioritise action.

7.9 The unreasonable attempt to extend (and enforce) the words contained in the legislation concerning a critical topic - consumers’ “*requirements and objectives*” - to embrace a multi-faceted collection of criteria, not all within consumer consideration, in the relevant ASIC Regulatory Guide 209. This beyond Ministerial expectation and beyond any Ministerial or Treasury co-ordinated consultation with the industry sector.

7.10 The treatment of ASIC Regulatory Guide content as if it were legislation passed by the Parliament, or regulation not rescinded by the Parliament, which was contrary to the division of powers under the Commonwealth Constitution, the introduction to every ASIC Regulatory Guide and evidence provided to the Federal Court by a senior ASIC lawyer.

7.11 A culture that, in public statements and in contacts with licensees, attempts to impose the legally improper and rejected draft Section 323A National Credit Code provision, being Schedule 6 of the National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012.

This rejected Bill, never presented to the Parliament, proposed to empower ASIC to simply declare that “*it was reasonable to conclude*” that a business activity or model was an avoidance “*scheme*” without the requirement for investigation or published justification, and with the burden of proof transferred to the licensee, rather than the officer alleging the breach.

This imposition contradicting Section 1(1)(a) of the ASIC Act, which requires ASIC to “…administer such laws of the Commonwealth…”, not create them.

7.12 Listing lenders in media releases in a manner implying that adverse court decisions (“outcomes”) had been handed down - which was not true.

8. Internal Review and improvement mechanisms

Concern: Mechanisms that operate in a vacuum, isolated from the external reality, may not deliver the best results.

8.1 The development and publication of ASIC Regulatory Guides without any industry sector consultation. This in contrast to the extensive opportunities provided by Treasury during the development of the credit legislation and regulation process.

8.2 The failure to include any industry sector representation on any relevant stakeholder ASIC panel or liaison committee.

9. Organisational governance and accountability arrangements - training and professional development

Concern: Again, mechanisms that operate in a vacuum, isolated from the external reality, may not deliver the best results.

9.1 Making it so extremely difficult and unpleasant to finalise arrangements for the Delegation to meet with senior ASIC officers, to present and discuss industry issues of mutual concern, that such discouraged further attempts at keeping ASIC informed.

9.2 Avoiding any opportunity to report to consumers and the general public on the outcome of penalty impositions and the associated success in the collection of fines and the repayment process.

9.3 Avoiding any opportunity to report to taxpayers as to the actual costs involved in the inconsistent prosecutions.

9.4 Not creating an opportunity for lenders and/or lender representatives to give presentations to ASIC training sessions.

Additional power for ASIC

The Delegation is most concerned to learn of general calls for ASIC to have more power. The Delegation is unaware of any such general call being accompanied by an objective study as to how ASIC is using its current powers in regard to the enforcement of compliance for small amount, short term lenders.

Should these calls attract any interest from the Expert Panel in regard to small amount, short term lending, Panel members are invited to consider the draconian amount of power which ASIC has already been granted by the Commonwealth Parliament over small amount, short term lenders.

The Delegation contends that no industry analyst has been able to discover an Australian industry sector more regulated and more subject to draconian penalty than the small amount, short term lending sector. Every element of the lenders' business processes, documentation, training and loan price is strictly regulated.

The Delegation notes that, in its current Discussion Paper concerning the statutory Small Amount Credit Contract Review, Treasury comments, "(the) *regulatory framework results in a great amount of complexity for* (small amount credit) *providers than for credit providers offering other products*".

This issue calls for more effective compliance enforcement - not more power.

It is very relevant to note the average payday or small loan offered by Delegation supporters varies between $250 and $500, with very few Delegation supporters lending over $5,000. However, the range of offences is extensive and the penalties frequently onerous.

There are two relevant Acts:

Part 2, Division 2 of the ASIC Act - particularly in regard to Sections 12BB (misleading representations), 12CB (unconscionable conduct), 12DA (misleading and deceptive conduct), and 12DB (false and misleading representations) provide ASIC with a very broad scope of power over Australian Credit Licensees - all attract penalties in the ASIC Act's most severe penalties range. Penalties include injunctions, adverse publicity orders, compensation to consumers, fines of up to $340,000 for individuals and up to $1.7 million for companies.

The National Consumer Protection Act includes very substantial opportunities for ASIC to exercise administrative power and impose penalties (fines, temporary cancellation or termination of licenses, substantial enforceable undertakings, orders to repay consumers), or to undertake prosecution.

In the NCCP Act, there are 126 criminal offences that do not have a gaol sentence as an option (72 of which attract strict liability), but have fines ranging from $510 to $17,000. There are 70 criminal offences that do have the option of gaol sentences, with fines from $170 through to $340,000 and gaol sentences from 3 months to 5 years (with 7 of these strict liability). There are also 114 civil offences each attracting a maximum fine of $340,000.

In addition, there are 34 overlapping offences, where the court can impose a penalty calculated as the total interest or permitted fees collected (up to $500,000) and, in these cases, the court can expand the coverage to include all consumers associated with a class of contracts. Further, for any offence, a court can order restitution or compensation for consumers, injunctions and adverse publicity orders.

Courts are also empowered to declare a contract void, in whole or part, with consumers being refunded, plus paid compensation for loss or damage. Courts can declare conduct unfair or dishonest, with the standard of proof being "more likely" (than not), with the opportunity for refunds, plus compensation for loss or damage.

In the lead up to the Capability Review, none of the calls for more ASIC power concerning the regulation of relatively small amount, short term lending, by any of the consumer advocates, have been supported by comprehensive and objectively collected evidence.

Where one-off examples have been cited relevant to the post-Commonwealth regulatory takeover, there has not been any attempt to consider actual or better enforcement of current legislation and regulation.

The Delegation contends that it is not a matter of more ASIC power that is required - what is required is more efficiency, more consistency between states and in the application of prosecution policy, more constructive contact with the industry sector in order to be better informed, better targeting and use of current ASIC power, along with a change in ASIC culture.

In this context, it may be useful to note the current message on the ASIC "*Welcome to the Consumer Credit Website*" includes the following:

"*The national regime has established a consistent and robust legislative framework. It gives consumers greater confidence and better outcomes when using credit products and addresses practices that could effect the stability of the industry, particularly the systematic provision of credit to consumers who cannot afford to meet the repayments*".

Further, there follows a comment concerning the legislation introduced on 1 July, 2010:

"*The main features... include:* (dot point 4) *improved sanctions and enforcement powers for the national regulator, ASIC...*". The Delegation was unable to discover any calls for more ASIC powers on this website.

In support of not extending ASIC's current powers, in a report released on 20 August 2015, ASIC Deputy Chair, Mr Peter Kell, stated that ASIC was not asking for changes to responsible lending law and said, "*the law as it stands allows us to push for higher standards*".

Conclusion - Compliance Benefits

The Delegation concludes where it began.

A successful Capability Review and a successful change to the current ASIC culture would provide clarity as to the application of compliance standards.

Competition will no longer be measured by how much more extraordinary profit the non-compliant lender is making, compared to the compliant lender.

A successful appropriate change will also mean the compliant lenders will not be left wondering whether or not ASIC will ever bother to demand compliance from the large non-compliant lenders and all types of lenders will be treated equally.

For the first time, a level playing field would exist that would encourage competition, including the opportunity for small and medium lenders to continue to participate in the market.

The Delegation thanks the Expert Panel and the Treasury Secretariat for their consideration of this submission and trusts that it has been of assistance.

25 September 2015