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Friday 22nd January, 2016

By email: consumercredit@treasury.gov.au

Ms Danielle Press
SACC Review Secretariat
Financial System and Services Division Markets Group
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Ms Press,

Response to the review of the small amount credit contract laws – Interim report

We welcome the opportunity to respond to the interim report of the review of the small amount credit contract laws, and to be able to have an ongoing voice as part of the overall review process.

Good Shepherd Microfinance commends the Panel for their hard work and dedication to ensuring that this review is thorough and inclusive of the voices of all of the stakeholders that will be impacted by any future enhancements.

This review process is vital to improving consumer protection and financial inclusion in Australia, particularly for those on the lowest incomes with the least consumer power and financial choice. We were particularly pleased to see the Panel emphasise the role of regulation in facilitating financial inclusion especially for vulnerable consumers.

The following response by Good Shepherd Microfinance has considered each of the observations made by the panel, and has offered our view on each of the options presented.

The key points of this document are:

- More accurate record keeping by lenders will improve ASIC's ability to enforce new laws.
- Mandatory participation in comprehensive credit reporting will improve compliance and enforcement capabilities.
- Tighter limits for repeat lending will enhance consumer protection and financial inclusion.
- Cost caps (along with improved disclosure requirements and lease length limits), are key to improving affordability and fairness in the consumer lease market.
- The interaction of new consumer lease laws should be carefully considered to ensure financial inclusion and consumer protection are in balance.

Finally, in order to enable consumers to access credit that they can afford and to support them onto a path of financial inclusion, it is critical that the Australian Government increases its investment in microfinance initiatives across Australia. The Centre for Social Impact estimates that there is an additional 325,000 consumers¹ who need access to safe, fair and affordable small loans. To meet this significant need, an increase in Federal Government investment from \$6 million to \$100 million per annum in operational funding would be required. This would also mean an increase in capital \$30 million to \$500 million, with a broader commitment from other sources.

I would be more than happy to discuss our submission with you further.

Yours sincerely,

A handwritten signature in blue ink that reads "Adam Mooney". The signature is written in a cursive style with a large initial 'A' and 'M'.

Adam Mooney

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¹ Centre for Social Impact, 'Life Changing Loans at No Interest: An Outcomes Evaluation of Good Shepherd Microfinance's No Interest Loan Scheme (NILS)',
March 2014

Payday Loans

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.

Further information is requested on trends in the SACC and leasing industries including consumer characteristics.

Good Shepherd Microfinance shares the Panel's view that a key outcome of regulation is to facilitate financial inclusion. The core business of Good Shepherd Microfinance is to promote financial inclusion, especially for women and girls, not only with regards to community based microfinance but in all aspects of commercial finance and mainstream banking. Regulation should be designed to promote pathways to greater financial inclusion, rather than permit an environment that enables exclusionary products and practices to prosper.

Regulation can and should encourage ethical and responsible lending by restricting practices deemed exclusionary, enhancing transparency and reducing asymmetries of information. At the same time, we do agree that caution should be taken not to over-regulate, which could result in even fewer financial options for consumers and inadvertently exacerbate financial exclusion. As set out by RMIT in their recent report², regulation that will have the consequence of eliminating the industry is not a solution, unless a more affordable and ethical option is available to the many consumers who currently use payday loans and consumer leases every year.

Therefore, Good Shepherd Microfinance continues to call for increased investment in community based financial initiatives to provide more choice to those consumers who are the most financially excluded, so that safer alternatives can fill any market gap created by future regulatory change.

It is our view that the negative impacts of payday loans and consumer leases are disproportionately affecting women who often turn to these products due to income inequality and financial exclusion. Around 70 per cent of No Interest Loan Scheme (NILS) clients are women in vulnerable situations such as being a single parent, being unable to work due to carer responsibilities, being paid less, or being underemployed through variable short term casual or contract arrangements which are increasing in the health, education and community sectors.

New research³ shows that women are increasingly using payday lending more. Over the past 10 years, payday lending among women has increased from 84,000 in 2005 to 177,000 in 2015. This represents a 110 per cent rise among women compared to a growth in the total population of 80 per cent over the same period.

The data from Digital Finance Analytics⁴ also shows that:

- While the size of an individual payday loan fell between 2005 and 2015 from \$776 to \$611, the average loan to female borrowers increased significantly from \$427 to \$592.
- Almost 50 per cent of the women using payday lending in 2015, were single parents and these women are more likely to have concurrent or multiple loans over the past 12 months.
- Payday loans initiated by women as the decision maker represented about 27 per cent of all payday loans in 2015.

² Trends in the Australian Small Loans Market, October 2015, RMIT

³ Women and Payday Lending, January 2016, Digital Finance Analytics

⁴ Women and Payday Lending, January 2016, Digital Finance Analytics

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.

Good Shepherd Microfinance agrees with this observation, as set out in our initial submission with case studies and other research that detailed the stress and harm that is caused by irresponsible lending, both financial and in terms of health and wellbeing. Good Shepherd Microfinance considers that the responsible lending obligations and the specific regulations for small amount credit contracts do not appear to be effectively protecting consumers, particularly consumers on the lowest incomes including Centrelink.

It is our view that reducing the ambiguity with regards to assessing loan suitability will improve the ability of lenders to comply as well as allow ASIC to more easily and effectively enforce legislation.

Additionally, to improve enforcement capabilities for ASIC it is crucial that loan suitability assessments are sufficiently documented by lenders, and call for this review to enact rules regarding record-keeping for small amount credit contracts.

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.

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

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.

Option 3: Extend the protected earnings amount for Centrelink recipient, 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.

Good Shepherd Microfinance agrees with the observation made by the panel that repeat borrowing is problematic, and that the rebuttable presumptions do not adequately protect consumers from entering debt spirals.

The options put forward in the interim report are a step in the right direction, and present both advantages and disadvantages. Our comments are set out below:

- **Explore a combination of options**
 - Good Shepherd Microfinance does not consider that these options should be either/or, and believes that a combination may be the most suitable avenue for consumer protection. For example, reducing the establishment fee for subsequent loans while at the same time limiting the amount of overall debt that can be incurred

(either through a percentage or over a specified time period) may be the most appropriate action to take.

- **Bright line test**

- Our submission to the inquiry called for a bright line test that would limit the number of SACC's that any consumer could enter into in a 90 day period, and we recommended that this limit be extended to include comparable consumer leases. We believe a bright line test will in practice be simpler to comply with than protecting earnings amount based on net income.

- **Establishment fee reduction**

- While option one will discourage a reliance on repeat borrowing from the perspective of the loan provider, it may have the unintended consequence of consumers choosing smaller loans upfront and larger subsequent loans. Additionally, if this was the only option chosen then there will remain no effective limit on repeat borrowing, and therefore could have little impact on debt spirals. However, it is possible that reducing the amount that can be charged for subsequent loans may encourage lenders to provide larger loans in the first instance, resulting in reduced costs for borrowers.
- An unintended consequence of this option may be to encourage consumer loyalty due to the benefit of staying with one lender, and discourage shopping around (although it is clear that the current SACC market has little price competition, it may do in the future and new regulation should not discourage competition and comparison shopping).

- **Comprehensive credit reporting**

- For both option 2 and option 3 it is crucial to have up-to-date information about current use of credit, particularly in cases where a client is in default (as this does not show on bank statements), and when they have taken a loan for which a fee has not yet been processed. As we set out in our original submission, we consider that mandatory credit reporting will provide this important resource, to ensure simpler assessment, easier compliance and enforcement.

- **Protected earnings amount**

- While assessing a net level of income on which to base a protected earnings amount is not impossible, and the benefit of this option is the simplicity and applicability to all clients, Good Shepherd Microfinance considers that it may in practice be difficult to comply with and to assess compliance, as the average net income amount over a period of 90 days may fluctuate significantly. Despite these concerns, in principle this option would provide strong protection for all consumers, both low income and otherwise.

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.

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

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

Good Shepherd Microfinance agrees that restrictions regarding default fees are vital to consumer protection, and we are also concerned that consumers are being disadvantaged by the method used by lenders to calculate such fees.

Addressing this issue is an important step towards ensuring the outcomes of this review are designed to promote financial inclusion. As the interim report acknowledges, for consumers on a very low income, or with very little surplus income, even a small increase in financial obligations can significantly impact the ability to meet housing costs, utility costs and to save for lumpy expenditure.

As set out in the interim report, there are a multitude of fees that can be incurred under default arrangements, and these can be charged at any stage in the default process. These vary considerably depending on the lender and can significantly increase the proportion of income needed to repay loans. We accept that when a consumer has repayment arrears or defaults there are costs incurred by the lender relating to communication and administration; however we are also aware of the detrimental impact of quickly mounting debt and high default repayments through the feedback provided by our network.

Our views are detailed below:

- **Explore a combination of options**
 - As in the previous section, Good Shepherd Microfinance does not see any reason why a combination of the options presented cannot be introduced to discourage lenders from recouping costs through default fees.
- **Limiting how quickly fees can be charged**
 - The most effective policy option that would promote financial inclusion is limiting the possibility for charges to unreasonably exceed the actual cost of the action taken to remedy the default. However, the use of the word “charged” creates potential problems, and we would recommend changing this to “incurred and charged”, to circumvent avoidance by lenders.
 - Financial modelling and research should be undertaken to rationalise a supplementary cap, which should be based on the actual costs to lenders, rather than the selection of an arbitrary amount (such as \$10).
- **Cap fees based on outstanding balance**
 - Additionally, we consider that capping default fees as a percentage of the amount outstanding on a SACC is both logical and fair, as it relates to the real potential losses faced by the SACC provider.

We are also concerned that there are additional fees and costs that can be incurred by a customer beyond default fees, including direct debit fees, fees associated with rejected direct debit payments and enforcement fees, and that for a consumer in default this can significantly increase the amount owed beyond the 200% limit.

Finally, as the panel rightly points out in their report, the cost of communicating with clients in default or at risk of default have fallen significantly with the rise of automated technology, particularly so for online lenders or those operating through smartphone applications. At the same time, it is clear that this automated technology could be applied to payment reminders prior to payments being taken, to reduce the likelihood of default and therefore further costs to both the lender and consumer. We would hope that lenders are also using this technology for this purpose. Responsible lenders will encourage consumers to proactively make contact if they know they may not be able to make a payment.

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.

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).

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.

Good Shepherd Microfinance considers that consumers should not be disadvantaged for making early repayments on loans, and should have the freedom to repay loans at any stage before the due date. Further, Good Shepherd Microfinance considers that people that can afford payday lending should pay a finance cost that is fair and reflects the underlying cost of providing that finance.

Our view is that any changes to the legislation should:

- Be simple to understand and transparent for both lenders and borrowers.
- Encourage lenders to provide loans to consumers based on needs and preferences, particularly with regard to loan length and repayment structure (rather than encouraging lenders to structure loans in complex and unclear ways to maximise returns).
- Intend simply to ensure that consumers are not paying for services that they are not receiving.

Consumer leases

Good Shepherd Microfinance supports the assertion made in the interim report that the consumers of most concern regarding consumer leases are those on low incomes and very low incomes.

Currently, Centrelink clients make up a significant proportion of the consumers accessing these arrangements and are often charged more for the same product and service than other consumers, as was clearly found by ASIC in *Report 447: Cost of consumer leases for household goods*.

As in our recommendations regarding payday lending, enhancing transparency for consumers is key to improving consumer protection and in turn improving financial inclusion. It is reasonable to assert that access to clear and accurate information at the start of the process will enable consumers to better exercise their agency and make more informed and considered decisions about entering into long-term financial commitments. This is important as consumers currently only know the potential cost of a lease following an inquiry, interaction with a salesperson and formal application.

Financial inclusion is multifaceted, and is not just about protecting consumers through strict limits and rules regarding eligibility. Financial inclusion is also supported by improving information asymmetries and creating an environment that allows consumers to make responsible financial decisions based on accurate and reliable information. As set out by a number of lenders and lessors in their submissions to this review, just because someone has a low income or accesses credit through these financial products does not mean that they do not possess the financial literacy to make responsible financial decisions given access to the right information.

Observation 6

The high cost of consumer leases appears to be causing consumers financial harm. While there are technical differences between credit contracts and consumer leases, these differences do not appear to justify consumer leases being excluded from the consumer protection regulations that apply to other forms of finance under the Credit Act.

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

Good Shepherd Microfinance can see no reason why consumer lease arrangements should be exempt from a cap on costs, particularly as all other products regulated by the Credit Act are subject to such limits.

The introduction of a 48% cap on costs would have a dramatic impact on the affordability and fairness of consumer leases, and would be a significant step towards using these arrangements to promote financial inclusion rather than exclusion. As Table 3 in the interim report clearly illustrates, this cap would instantly reduce the overall amount that can be charged through a consumer lease from 2-5 times the cash price of the goods to 1.26 – 1.89 (one to three year lease lengths). As we suggested in our previous submission, limiting lease lengths is also an important factor in capping the costs of consumer leases, and will discourage avoidance behaviour by lessors.

As set out in the interim report, defining the types of leases to be capped under new regulations is not simple. Our view is:

- Setting a maximum value for transactions to come under new regulation is not ideal, particularly if that limit is set at \$2,000 as suggested in the interim report. Many products obtained by consumer lease cost more than \$2,000.
- The cap should apply when it is expected or implied that the consumer will possess the goods at the end of the contract, this includes if the good is gifted to another person or ownership of a similar good is an option. As we have previously argued, consumer leases are often simply credit-in-disguise, and consumers are routinely confused about their rights and obligations for ownership. Regulation enhancements must address the current industry practice of drafting contracts to avoid cost caps while at the same time clearly implying that the consumer will own the good at the end of the lease.
- The cap should also apply to other rental agreements for household items.

- This must include tighter rules around disclosure and transparent marketing and advertising, so consumers are able to make informed and responsible choices.
- This must also include consideration by legislators of the potential for consumer lease companies to continue avoiding cost caps by offering indefinite leases to consumers as an alternative.

Stipulating how the cash price of rental goods is determined is also not simple and must be carefully considered to be sure this aspect of regulation does not become a mechanism for avoidance. As mentioned in the interim report, this is particularly so for second-hand items or own-branded items that are manufactured in-house by rental companies. The approach referred to in the interim report from the *Credit Act 1984 (NSW)* is comprehensive, although will have to be actively enforced by regulators to be effective.

Observation 7

During consultation, stakeholders noted that a large proportion of the cost of consumer leases can be attributed to add on products. There is little transparency regarding the nature or cost of these services and the value that they provide to consumers. It may not be clear to consumers that these features are available when they enter into a lease, or that they extend beyond the statutory guarantee under the Australian Consumer Law.

Option 10: Include the cost of add on features and products under the cap.

Good Shepherd Microfinance considers that many additional products and services included in consumer leases do not justify the high costs that are often charged, are not transparent to consumers, and do not offer value for money. We consider that in many cases consumers would be better off paying less and not receiving the products and services, as in many cases they are unaware they exist and do not access them anyway.

For this reason we agree that the cost of add-on features and products should be included under the cap, and that this will ensure that they represent value for money for the consumer and are not used as a loophole for recouping costs.

The only exception that could be reasonable to allow may be for the upfront costs of delivery, particularly for rural and remote regions, but only if these costs are reasonable.

Observation 8

If a cap were to be introduced on a restricted category of consumer lease, it should be designed in a way that limits the risk of avoidance.

Although extending a cap to all leases and broadening the scope of the Credit Act to include indefinite term leases are matters outside the terms of reference of the review, government may wish to consider the implications for those leases outside the scope of this review.

- **Indefinite Leases**

Good Shepherd Microfinance agrees with the observation with regard to indefinite lease terms and with the Consumer Action Law Centre on this matter in their submission to this review. That is, the justification for having different rules for fixed term leases and indefinite leases is unclear and has the risk of encouraging avoidance.

The risk to further financial stress and exclusion is high with regards to this matter, and we urge government to consider the implications of changes to regulation, and the need for further regulation of the indefinite lease market.

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

Good Shepherd Microfinance supports consumer protections that limit the potential for financial exclusion through overburdening consumers on low incomes with too many financial obligations.

It is our view that capping total costs for consumer leases at 48% and implementing a combined cap for consumer leases and SACCs will result in significant improvement in consumer protection for this industry. However, we have addressed each aspect of the regulation separately below:

- **Combined cap for SACCs and consumer leases for all consumers**
 - Many consumers, including many of our clients, are repaying a combination of both consumer leases and SACCs. For this reason, as well as the fact that small amount credit contracts and the majority of consumer leases are in substance the same product, we support the introduction of a combined cap that covers both SACCs and consumer leases either through a protected earnings amount for all consumers or through a limit on the total number of credit contracts that can be entered into during a prescribed period.
 - A combined cap must be supported by mandatory participation in comprehensive credit reporting to ensure that responsible lending decisions are made with access to up-to-date information, and to support effective enforcement and investigation by regulators.
 - We support a combined cap that covers both SACCs and consumer leases for all consumers, either through a protected earnings amount or limit on the number of credit contracts allowed in a 90 day period.
- **Additional caps for consumers on low incomes**
 - Financially inclusive consumer protection must also include a further cap on the amount that can be charged for a **single consumer lease contract** for all consumers on low incomes (those receiving a Centrelink payment or an income under a specified threshold), to prevent lessors from overcharging these consumers due to their lack of other financial options and purchasing power. Currently the current average fortnightly repayment through Centrepay for consumer leases is just under \$76⁵ that is a very high proportion of fortnightly income for these consumers.
 - We recommend a limit for a **single consumer lease contract** for consumers on low incomes.
 - Stipulating this limit without knowing what other consumer protections will be in place and how they will interact is difficult.
 - One option could be 5% of net income, however with a cost cap and other potential limits such as a protected income amount for all consumers this may have the unintended consequence of reducing access to more expensive goods (and reduce financial exclusion).
- **Limit lease lengths**
 - Lease lengths should be limited to ensure consumer lease companies do not recoup profit through longer leases and to ensure that consumers on very low incomes are not overburdened with long-term financial commitments.
 - We recognise that specifying lease lengths is complex, as we are aware of the need to balance fortnightly repayment affordability with overall lease cost (see Table 1)

Finally, our analysis (below) shows that an interest rate cap for consumer leases, lease limit length and additional protected earnings amount for a single consumer lease contract, may result in higher value

⁵ A Buduls, Report of the independent review of Centrepay, report to the Secretary of the Department of Human Services, Australian Government, June 2013, page 74

products being unavailable to those receiving the Centrelink payments and the lowest incomes. This would not be an optimum outcome of this review.

We must emphasise that we make these recommendations based on the current regulations in regard to **each specific aspect of the legislation**, but caution that further modelling and analysis must be undertaken to ensure that a combination of tighter regulations promotes financial inclusion, rather than exclusion.

Table 1: Consumer lease repayments with 48% p.a. interest rate cap

Consumer lease with 48% p.a. interest rate cap				
Value of goods	\$500	\$1,000	\$1,000	\$1,000
Term of lease	1 year	1 year	2 years	3 years
Fortnightly payments	\$24.23	\$48.74	\$30.04	\$25.25
Total payments	\$630	\$1,267.17	\$1,561.98	\$1,891.27
Multiple of cash price	1.26	1.26	1.52	1.89
Disability Support Pension (fortnightly)	\$867			
Payments as % of income	2.8%	5.6%	3.5%	2.9%
Newstart (fortnightly)	\$523			
Payments as % of income	4.6%	9.3%	5.7%	4.8%

* Percentages highlighted in pink indicate which repayments would exceed a threshold of 5% of net income per contract.

Therefore, we emphasise that more funding and resources must be invested to enable community finance programs such as the No Interest Loan Scheme (NILS) and other financial inclusion initiatives to expand and fill any gap in the market created by tighter regulation, and call for further state government, federal government and private sector commitment to such programs.

Option 12: Prescribe the maximum amount that can be charged on early termination of the contract.

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

Good Shepherd Microfinance supports the introduction of limits to how much can be charged for early termination of consumer lease contracts.

We are hesitant to stipulate an exact formula or amount to be applied for early termination, but consider the following to be important aspects for this matter:

- Transparent and easy for consumers and lessors to understand.
- That the amount is both reasonable and enforceable.
- That the lessor will have the opportunity to re-hire or sell the returned item.

With regards to early termination fees, our view supports the view of the Consumer Action Law Centre, and we draw the Panel’s attention to their detailed response to a Treasury discussion document on this specific matter available [here](#).