Min-it Software

SACC Review Secretariat Consultation –

Review of Small Amount Credit Contract legislation and Consumer Leases

Supplementary Submission following release of Interim Report

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Comments on the Panel's observations

Our Concerns

Given the Interim Report states "[t]his consultation process is the primary source of information for the interim report[1]" we have a number of major concerns with the information the Panel appears to be accepting as indicative of industry practice.

1. The Panel has extensively quoted statistics or drawn conclusions from two surveys with which we have serious doubts as to veracity. For example, as we have more clients than any of the Industry Groups has as members, we asked all our clients if they had provided any information to either but:
   - only **3** have stated they provided information for the CoreData survey. We know from the questions asked they would have been able to provide only limited information as they did for the ASIC survey; and
   - **not one** provided any information to Digital Finance Analytics.

   We have been advised the CoreData survey results were based on the data provided by **just 22 lenders** but most of these provided just some basic data as did our three clients. As a consequence, CoreData has relied on the more extensive data provided **by no more than 6** major and mainly online lenders. It is, therefore, not conclusive of what the majority of industry participants are doing, just those 6.

   We have also reviewed the methodology of the Digital Finance Analytics survey. It uses its own household survey data, including that obtained a number of years ago, to extrapolate what it believes is occurring in the industry rather than actually surveying any lender or its borrowers to derive

[1] Interim Report, p.4.

any accurate data[2]. We have not been advised by any of our clients that any of their borrowers had been canvassed for a survey by Digital Finance Analytics ("DFA") in the past year and had this occurred, we would have been advised.

It must also be remembered that the DFA report was commissioned by Consumer Action Law Centre, Good Shepherd Microfinance, and Financial Rights Legal Centre. These are hardly 'independent' bodies and some of the 'survey results' use data from pre-Enhancements Act enactment. We submit the DFA's survey data are no more than guesstimates at best. The methodology used does not guarantee any objectivity and is subject to a high risk of experimental error.

The Panel should not place any reliance on its findings as **not one lender** provided any **current** data to it.

For this reason, we do not accept either survey provides the Panel with any true indication of what's occurring in the industry as a whole and casts doubt on some of the conclusions the Panel has accepted, made or alluded to in respect of SACC borrowers by using it.

2. Credit Corp uses a fully automated system and the information provided to the Panel by it should be taken as applying purely to that credit provider. It does not apply to the industry in general. The Panel should also take note that another credit provider, Nimble, has been forced by ASIC to partly de-automate so that it can become more compliant. As ASIC has stated to the NCPA[3] that the automated systems currently in use simply do not enable

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[2] North, M, 2015. Digital Finance Analytics Blog, *Payday Lending's Online Revolution*, 01 June 2015. Available online http://www.digitalfinanceanalytics.com/blog/payday-lendings-online-revolution accessed 16 January 2016.

[3] ASIC, 2014. Emailed response by Chris Green to Phil Johns, CEO NFSF (now re-named NCPA) dated 24 November 2014 regarding use of

lenders to perform their responsible lending and loan suitability obligations properly, the fact that ASIC has not investigated any other automated lender to date doesn't imply its systems are compliant.

Whilst Credit Corp, when trading as Wallet Wizard, claims not to be a 'payday lender', it advertises that it provides loans for terms greater than 4 months from \$100 - \$5,000[4]. As the vast majority of payday loan definitions are for loans no more than \$500 and generally for 3 months or less, the fact that it provides its loans over a 4 month minimum doesn't alter the fact that they really are still a payday loan.

If you look at what it charges, being a 15% establishment fee and a 2% monthly fee, a \$100 loan for a 4 month term paid monthly would make a total payable amount of \$123.00. In contrast, most other lenders would require payment over a term of 5-6 weeks for such a small amount and the total payable, using the maximum 20% establishment fee and a 4% monthly fee, would require a total repayment of \$128.00. That is a \$5.00 difference, hardly significant and well within any market-driven competitive price range.

Given it uses a totally automated system, however, it is arguable that Credit Corp's true establishment cost should be a maximum fixed cost of \$45.00 for all SACC's rather than the 15% it does charge on SACC's as that is what it charges for **all** its MACC contracts. Equally, the SACC loans it provides return a monthly fee return in lieu of interest of 24% flat amount for a 12 month period whereas the 39% interest rate it charges on its MACC loans provides an equivalent 22.65% flat when the loan is paid weekly. Any SACC loan over \$300 returns the company far more in establishment fees than it derives from its MACC loans and it's also getting a higher return via the

automated lending assessment systems

4 Credit Corp Financial Services Pty Limited trading as Wallet Wizard, 2015. Website http://www.walletwizard.com.au/costs/ accessed 24 December 2015.

monthly fee for SACC's than it does obtain from any interest. All this suggests its SACC clients are actually cross-subsidising those that borrow higher amounts. There may be other cross-subsidisation occurring given Credit Corp's core business.

We note with interest, too, that Credit Corp chose not to disclose its dishonour rate. The author knows from years of debt collection experience that borrowers get tired of paying loans over longer periods, particularly where any benefit that may have been evident at time of contract execution has long since disappeared.

As a major direct debiting entity ourselves, we can advise the Panel that the vast majority of online lenders have dishonour rates, on average, almost double that of our own Min-it Software client average.

The NCPA has long argued that automated systems, set up with the 'right' algorithm, should be able to process an application with greater speed and consistency than a human. On the basis that electronic decisioning systems are capable of doing this, they have argued that the ability to provide "instant" credit is feasible. As a generalisation, to date, most algorithms are incapable of doing this and ASIC has said so[5]. The problem is the lenders that use these totally or almost-totally online systems are encouraged by their various systems to create the loan requested, regardless of whether they are compliant or not.

The fact that our larger clients, who have some level of automation for the loan application process itself, can have dishonour rates that typically fall with a +/-5% range of the average dishonour rate for all our Min-it Software clients, shows that it's the fully or almost fully automated systems used that

[5] Ibid 3

are the issue here. A greater dishonour rate shows either:

i. assuming the consumer has only the one loan, the lender has not done sufficient responsible lending enquiries at the time of application; or,
ii. if the borrower has applied for and received additional credit from other lenders since credit was advanced, the original lender may suffer a higher dishonour rate due to the consumer juggling payments between the various lenders.

To show that most major online lenders simply do not adhere to the SACC responsible lending and loan suitability obligations, please refer to Appendix 1. This shows part of the reporting by CreditSense of new loans issued for a borrower earning $800 per week in the previous 90 days for a loan application made 6 January to one of our clients.

The transactions have been rearranged from that provided to our client to show the order of the initial amount of credit deposited into the borrower's account. To our knowledge, only one of these lenders does not use a totally automated system. Based on this report, which also showed this individual had a number of dishonoured payments, she had managed to obtain $4,270 in the prior 90 days. The client who referred this to us also uses some automation in its application process declined to provide further credit because of the presumptions of unsuitability. This same client also declined 29 applications in just 3 hours on 20 January purely because of the prior number of SACC's these borrowers currently have.

This shows that the Panel should not judge **all** lenders by the actions of the few that flagrantly avoid adhering to the NCCP requirements. Had most of the lenders shown in Appendix 1 followed the same processes as our client, this borrower could not have borrowed anywhere near the amount she managed to obtain and would not be in as deep financial strife as she has got herself into.

3. We argue the comment "more SACCs are being provided online instead of at bricks and mortar shopfronts as a result of improvements in technology[6]" may be only partially true. There is a difference between "being provided" and "being applied for". Some bricks and mortar lenders have seen massive increases in building rental costs due to ratchet clauses in lease contracts, forcing many of them to either go online or seek cheaper accommodation, so the reason why the percentage of SACC applications being applied for online has increased is purely to try and cut costs, nothing more. As the author stated in Melbourne, the rate of declined application for our clients is between 70 to 95% whereas Cash Converters said theirs was 40%. With fixed maximum fees for SACC's enshrined in legislation, there is a clear financial objective for any lender to minimise costs wherever possible.

   Society and generational differences have created an expectation of immediacy; individuals want everything their parents had now. Technology has undoubtedly played a part in the online application process but as stated previously, that doesn't mean to say those lenders are compliant and that they have strictly followed the legislative requirements of responsible lending and loan suitability obligations. We suggest Appendix 1, at best, shows some of them haven't.

4. Some of the information provided by the consumer groups uses information from well before the introduction of the Enhancements Act. Given the major

[6] Ibid 1, p.5.

change the Enhancements legislation thrust on the industry, we assert the comparisons they have provided are unfair and inappropriate. The Panel should use only verifiable information from the introduction of the Enhancements Act.

5. Whilst we note and applaud the Interim Report's concerns about protecting the poor and vulnerable from debt spirals, legislation should not go so far as to make the industry unviable. Our clients do not lend to the poor; they simply cannot afford to repay. We believe some of the options do so and these will be covered in more detail.

6. The number of Australian Credit Licences ("ACL") issued is not a valid indication of the number of actual new entrants to the industry. In the past 3 years, we have had a significant number of prospective clients decide not enter the market, despite having successfully obtained an ACL, because:
    a. market conditions and some of the erroneous perceptions surrounding SACC's was not conducive to entry, or
    b. their Responsible Manager has left the credit provider and ASIC has refused to accept the suggested replacement(s).

7. We must take issue with the Panel's statement under the heading 'Cap on interest rates for credit contracts' that "[u]nder the Credit Act, credit providers are only permitted to charge a maximum of 48 per cent interest on a credit contract", citing Section 32AA of the National Credit Code("NCC"). It is regrettable the Panel appear to have made this factually incorrect statement as, following the implementation of the Consumer Credit Legislation Amendment (Enhancements) Act 2012 ("Enhancements Act") and the

removal of maximum interest rate caps that applied under the transitional credit transfer of powers legislation of New South Wales, Australian Capital Territory, Queensland and Victoria, there is and never has been an interest rate cap apply under the National Consumer Credit Protection Act ("NCCP Act").

There is, however, a prohibition of entering into a credit contract where the Annual Cost Rate ("ACR") exceeds 48%[7]. Section 32AA only applies where:

1. the lender is not an ADI; and
2. the credit contract is not a SACC or a bridging finance contract; and
3. either:
    i. the annual percentage rate, or
    ii. the credit cost amount

   is increased after the contract has been entered into; and
4. it causes the ACR to exceed 48% if, at the time the contract was entered into, the changes had been taken into account for the purposes of calculating the ACR.

An ACR **cannot** be defined as an annual percentage rate (i.e., an interest rate) because of what the formula takes into account in deriving the value. Depending on the loan parameters, it is possible for a loan to have a higher than 48% interest (annual percentage) rate applied and still fall under the maximum ACR.

For these reasons, we trust the Panel makes recommendations to the Minister based only on verifiable facts and accurate analysis of the existing legislation rather than guestimates and supposition by some submitters.

[7] Section 32A(1), National Credit Code

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.

We wholeheartedly agree with this observation but cannot find any suggestion as to how the Panel believes this should occur. The vast majority of our clients that provide consumer credit contracts have always been of the opinion that part of their role was to assist their borrowers ultimately be able to source mainstream finance but the Big 4 banks and others have, for many years, refused to provide finance to anyone with a credit enquiry from what they term a 'third tier lender' on a Credit Report. It is the legislation itself, together with the ADI's own policies, that promotes financial exclusion.

We note the Panel has suggested the size of the industry is "between $700 million to $1.2 billion in terms of funds advanced per year and that between 500,000 to 1 million consumers use SACCs each year[8]." That difference, unfortunately, represents a possible error rate of around 33%, well beyond the level for most acceptable standard deviation. Based on readily available public information, such as from the ASX-listed entities, and what we know our clients are writing, we are of the opinion that the SACC market may actually exceed $1.2 billion.

We were interested to try and locate the RMIT finding in its submission that a "higher proportion of consumers who use online-only lenders are employed (around five employed consumers to each unemployed consumer for online-only lenders compared to two employed consumers for each unemployed consumer for lenders with a bricks and mortar presence)[9]" but could not find it as it flies in the face of

[8] Ibid 1, p.5
[9] Ibid 1, p.6

common sense. The vast majority of lenders in the SACC and MACC sectors are self-funded. Consequently, if a small lender loses capital, it's usually a personal loss and it makes no sense to lend to such consumers.

No business enters into the marketplace to lose money and for that reason, as we have repeatedly informed Governments, both State and Federal, almost none of our clients will ever lend to those on New Start or Austudy benefits. If they do, it is a rare exception to assist a valued client as a one-off measure.

However, even if the statement is true, exactly what criterion was used to define an 'unemployed person'? If the individual is a New Start, Austudy or similar low amount benefit recipient and not working, then we can agree with the definition. If, however, a consumer is receiving a different (such as a disability) benefit and also not working, is that person best described as a beneficiary or unemployed? We would suggest the former is more appropriate as the intention is those receiving New Start need short term assistance.

Cash Converters, on the other hand, has openly stated it targets those on New Start benefits even though those in receipt of New Start can do little more than subsist because the benefit amount is so low. Given its market dominance and its propensity to lend to such individuals, it is not unsurprising to find that some of its stores may lend more to the unemployed than to those who are employed. As a general observation, though, we doubt they are widespread.

Given what we have stated in our concerns about some online lenders, we suggest the Panel should consider whether it is more appropriate to allow the use of certain technologies if they do nothing for compliance.

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.

The author is in fairly constant contact with a number of specialist credit lawyers and four of them have expressed total disbelief that the Interim Report states that additional protection is required for SACC's. They are all of the opinion ASIC should be undertaking more enforcement to ensure a level playing field.

ASIC's report 426 may have found the rates of compliance to be low but the sample it used was already skewed in finding such an observation as it used some lenders that it had already identified as being deficient. Using any of that report to justify an argument is a misuse of statistics.

We do partly agree with the CIO of the Credit and Investment Ombudsman ("CIO") statement that <u>some</u> (but not all) "SACC lenders appear to have difficulty with the concept[10]" of responsible lending as Appendix 1 shows the major online lenders appear incapable of adhering to the responsible lending and loan suitability obligations.

We were surprised, though at his statement that "the 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"[11]. We are not aware of any of our clients having surrendered

[10] Ibid 1, p.8.
[11] Ibid 1, p.8.

any of their operational manuals or other training documentation to CIO for review as part of an investigation. To our knowledge and based entirely on information provided by our clients, prior to the issuance of an Australian Credit Licence, ASIC has called for and reviewed various manuals. Without exception, one of these has always been the one covering Responsible Lending. It would appear this is proof CIO has set itself up as a defacto regulator (as we have always claimed) but we are unsure exactly how many lenders his statement might refer to.

All the lenders will undoubtedly have received the consumer's 90 day bank statements. ASIC's call for brightline tests appear be to more for its own ease of enforcement and enabling online lenders more easily comply with the requirements than enforcing the current legislation. Legislation should not be framed so as to be anti-competitive or to suit one technological delivery method.

One of the greatest difficulties the industry has faced with the principles-based NCCP Act legislation, though, has been the lack of consistency from ASIC, both by individual officers and with different branches demanding different things. We have seen investigations by ASIC officers ignore blatant Code breaches and it has a policy of refusing to engage in any meaningful manner about aspects of compliance when it involves another party. This makes it more than difficult to understand ASIC's position as to why it has done or refuses to do certain things.

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.

As we stated above and in our original submission, the Interim Report's statement "the repeat use of SACCs with terms of up to 90 days is common practice in Australia[12]" may be true for about a dozen major online lenders that transact a substantial percentage of all SACC's written but the Panel should not judge the entire industry based on this small subset.

The market conditions in the UK were substantially different from those in Australia when the UK's Competition and Markets Authority undertook its survey in 2014 and whilst we know there are a number of consumers in this country that have had more than 6 payday loans in one year (some as high as 25 in just 90 days), excluding the subset described above, we do not accept this would be the case for the majority of Australian lenders. Our clients would not have the declined application rates as high as they do if they were lending in the same manner as some of these majors are. We are not aware of the regulator ever taking action against any lender for breaching the unsuitability requirements applicable to SACC's.

The statement "[t]he cost of providing a returning customer with a subsequent SACC is significantly lower than the cost of providing a SACC to a new customer, given that customer has already been acquired[13]" is incorrect. Whilst there may be no acquisition cost, the NCCP Act requires a new assessment every 90 days[14] and also "the current cap does not recognise the difference in the upfront cost of providing a new loan compared to a subsequent loan[15]", the actual establishment

[12] Ibid 1, p.9.
[13] Ibid 1, p.11.
[14] Section 128, NCCP Act.
[15] Ibid 1, p.11.

costs for this will or should be the same as applied for the original loan and will include any declined applications the lender undertakes.

The Interim Report is confusing the cost of acquisition with the cost of establishing the loan. Furthermore, the statement “[p]rofit margins on the second, third and fourth SACC appear significantly higher than the profit margin on the first SACC. This would make repeat borrowing attractive to all lenders even if they are able to make a profit on the first SACC[16]” is **totally** incorrect.

We are aware some lenders are paying lead generators, who operate both internally and internationally, anything between $25 and $350 per lead. The Interim Report states it believes the average cost of acquisition is around $200. If this includes failed leads and any other advertising costs (such as TV, radio, Google Adwords, etc.), the suggested $200 may well be too low. Anecdotally, we have been advised the average fee being paid by many lenders is over $120 (plus GST). However, when one considers the total income receivable is $112.00 for a typical $400 loan over a term of 5 - 6 weeks, taking into account the lenders fixed costs to generate the loan contract, it will take many loans just to recover this fee and another before the lender actually starts to make a profit.

Using information supplied by Cash Converters in 2011 at a meeting with the then Minister, the Hon. Bill Shorten, at a meeting held in Moonee Ponds on 9 September 2011, for example, it stated its fixed costs then amounted to 70% of the total fee charged. Using this same figure today, it would mean it would take 4 loans just to break even and a fifth to turn a profit. Add in the cost of the fees paid for leads that do not eventuate into any contract together with high dishonour rates and it can soon be seen as to why there are number of large online lenders’ businesses

[16] Ibid 1, p.11.

currently on the market. The acquisition cost is just too high. It also explains why so many online lenders provide leads to borrowers for whom the loan ought to declined.

In addition to the issue of substantial hardship that we have already advised the Panel of, we suggest part of the problem is the wording of s.131 (2) (a). This section states

> *"The contract will be unsuitable for the consumer if, at the time of the assessment, it is likely that:*
>
> *(a) the consumer will be unable to comply with the consumer's financial obligations under the contract, or could only comply with substantial hardship, if the contract is entered or the credit limit is increased in the period covered by the assessment;"*

From the author's participation in the Treasury Credit Industry Group meetings as the Financiers Association of Australia representative, sub-section (a) is meant to require the lender take into consideration all of the borrower's other financial commitments and then assess whether or not the borrower can afford to repay the new loan in addition to these or only do so with substantial hardship. If they can't, then it should be deemed unsuitable. Not all lenders accept this premise, however, and an argument that has been put to us by another lender, based on advice it received from its own solicitor, suggests the lender only has to look at the **new** loan and not take into consideration any of the borrower's other financial commitments. If the lender believes the borrower will ultimately pay the loan back, even with some defaults, this lender firmly believed they were compliant, no doubt based on the legal advice it had received. We are unsure how prevalent this belief is but we doubt it is restricted to this one lender.

We suggest s.131 (2) (a) could be strengthened by adding three words, shown in red bold font, as follows:

(a) *the consumer will be unable to comply with the consumer's* ***existing*** *financial obligations* ***and those*** *under the contract, or could only comply with substantial hardship, if the contract is entered or the credit limit is increased in the period covered by the assessment;"*

By avoiding or failing to apply the presumptions test properly, the few major lenders that seemingly offer funds to anyone that applies cause other, possibly more compliant, lenders to have cashflow difficulties depending on how aggressively it engages its debt collection activities.

In early 2007, we undertook some data analysis of our client base and at that time, the average rate of a returning client was 39%. By 2009, this had increased to 83%. This was not a reflection of the amount of loans being written, just merely the loyalty value. The author has been personally advised by a senior manager of one online lender that loyalty amongst internet borrowers is now measured in the low teens whereas for bricks and mortar based lenders, it is much higher. The level of personal service offered by such lenders has become a significant point of difference. That means for the online lender, without successive repeat borrowing, the cost of acquisition is likely to be spread over at least twelve months because there is no guarantee that a client will return to the last lender when seeking another loan.

<u>Option 1</u>

Without actual proof and not the suggestion of either a consumer group known to be committed to seeing the payday industry sector removed or the data provided by just one large online lender who has ulterior motives, it is supposition that lenders do not face the same costs for repeat loans to the same customer. If the Panel has actual proof of this, perhaps based on Treasury data modelling using information gathered from a variety of lenders and not just the online majors and the three ASX-based entities, it should be provided to the industry to verify.

As a software developer, we must ask what exactly constitutes a returning customer? In our opinion, this would require some definition to be established as is a returning customer one that:

a. takes out a consumer credit contract immediately after paying out an existing contact? ; or
b. takes out a consumer credit contract within a set period of time (yet to be defined); or
c. is in the lender's system as having taken out a contract at any date previously?

If this applies purely to SACC's, in the case of any of these, if the consumer has only had a MACC or 'Other' contract, are these to be excluded from any determination?

Option 2

Whilst we can see the merits of the brightline test from ASIC's perspective, it may encourage some lenders to offer two SACC's at the same time rather than one as sought by the borrower. As the largest lender, Cash Converters already does this and its actions may already be construed as a misuse of power under s.46 of the Competition and Consumer Act 2010 (Cth). They do it to protect their own interests because it forces the rebuttable presumption test be applied immediately the borrower seeks another loan in the 90 day period. Applying a brightline test of no more than 2 loans in 90 days also doesn't help the borrower in need of further funds to pay for an unexpected expense; we would envisage our clients witnessing even more desperation than exists now if they are prohibited from assisting such clients. Credit is used to assist individuals ride over the peaks of financial demands and stopping credit isn't going to assist.

Given the high acquisition costs faced mainly by the bigger lenders, problems we do see with implementing option 2 are:

i. it will likely see some illegal lenders entering the market to cater for those borrowers desperate for money (as a number of individuals are known to have already asked how this could be done); or

ii. some lenders will resort to refinancing an existing SACC with the kind of loan currently offered by Dollars Direct where it nominates a credit limit of $2,025 even if that amount of funds is never advanced; or

iii. there will be some further 'work-arounds' introduced.

Option 3

Many of our clients already state they keep the total the consumer repays for all loans to around 20% of net income, with one keeping it to no more than 15%. Whilst we would support a move to apply the 20% protected earnings amount currently applying to Centrelink recipients to all borrowers, the clients we have spoken to have advised us very loudly that reducing the protected earnings amount to 10% net for all borrowers would cause them to leave the industry. Even going overseas would not enable them to stay viable.

There is, however, an issue with taking such a tack. Centrelink recipients generally receive the same benefit amount and it doesn't change much from payment to payment. There are occasions, though, when it does, such as when a benefit is suspended or the Centrelink beneficiary is paying back a loan. Calculating and then applying the 20% protected earnings amount, whether it be gross as now or net as is the suggested option, is rarely an issue.

For ‘ordinary’ borrowers, however, this is not going to be so straight-forward. For example, there is already difficulty now in establishing the periodic income for seasonal workers and for those in temporary employment (e.g., see Example 13, RG 209.118). Many borrowers also earn overtime, which may vary from week to week. How exactly is this to be taken into consideration?

We would like to take this opportunity of advising the Panel that when the New South Wales and more particularly, Queensland, introduced their interest rate caps, many of our really good, long-standing clients that had been lending for many years without issue decided to leave the industry. Despite the introduction of licensing, we have seen a number of entrants that really should never have been given an Australian Credit Licence. Many of the issues raised about how to curb irresponsible lending are really about legislative knowledge, enforcement and poor drafting of the legislation. We would urge the Panel not to try and create even more of a nanny state than we have now. Not all lenders operate unscrupulously and we don’t need more draconian legislation to deal with the few that operate non-compliantly.

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.

We have yet to see any contract that doesn't define when 'default' occurs and we are surprised the Interim Report has chosen to raise the issue of what constitutes default under a credit contract. If a contract were not to define it yet state that default fees were payable, it is arguable that the contract is misleading and deceptive. ASIC already has sufficient powers to deal with this, under both the ASIC and NCCP Acts.

Most contracts define default occurring if a payment is not received by the due date. For non-SACC contracts, there may be other definitions of default applicable in addition. The Panel will be well aware there is usually a clause in a contract that effectively makes an allowance where the due date is due on a weekend or public holiday but default will occur if payment is late, by even one day. This is no different to what many other entities apply for a late payment. For example, where a telco or local council charges a fee for a late payment or a state government department applies a penalty fee for paying a vehicle registration a day late. Some credit cards also charge their late fees even when a day late.

We can only speak for our clients but we have yet to see a single one set out with the intention of deriving more income from default fees than from any other source. In contrast, we do know of one major lender that provides personal and business loans together with credit cards that earns around 80% of its fees from the 20% of borrowers that fail to pay on time.

For lenders, the greater the number of dishonours there are, the more work that must be done to collect the debt and that means employing more collection staff; a significant expense. Technology can reduce the way some of these costs are managed but at the end of the day, personal intervention is usually the only way to secure recovery.

In almost all instances, often after contacting the client by telephone, our clients simply extend the loan term in the event of a payment default. Whilst a dishonour or missed payment fee may well be applied by the lender, even though it's still an event of default under the contract we supply, they may choose not to issue a s.88 Default Notice because that aggravates the lender/client relationship. However, if the initial payment is missed or dishonoured, that is not a good indicator and we do recommend our clients issue a s.88 Default Notice in such cases. Unless brought to heel quickly, the lender is likely to lose all its capital advanced.

We would also remind the Panel if that first payment was attempted by direct debit and it failed, the lender is legally required to issue Regulation Form 11A. The Panel may not have taken this into account, particularly for option 4 (see comments below).

As we appear to be the only software supplier to the industry sector to have received a Consumer Protection Award[17], for our clients, depending on the loan parameters and the final scheduled repayment amount, whilst it means the borrower will also incur an additional monthly fee, the borrower is not significantly affected by their payment default at that point in time. We contend if a borrower can't pay the repayment due, it's unlikely to be able to afford to repay that payment plus any dishonour fee the lender may have applied if the payment is simply rescheduled.

The same cannot be said for all lenders though. We have been shown evidence

[17] Min-it Software received a "Highly Commended TradeSmart Award" for Consumer Protection from the Queensland Department of Fair Trading in 2007.

of a number of non-client lenders consistently rescheduling payments unilaterally in contravention of s.65 (1) of the NCC and presume this is how their systems work. We are unaware if there has been any enforcement action taken by ASIC in respect of this.

The fact that SACC clients may have more dishonour fees applied is simply a reflection of:

i. the fact most clients repay weekly or fortnightly and align the repayment due with their pay days rather than paying monthly; and
ii. poor responsible lending practices by the major online lenders that affect other lenders' income when the consumer starts to juggle payments.

The amount a lender charges for default is non-standard because it reflects the lender's costs and what it does. Our clients may charge a variety of fees that can only be charged when the loan is in default for a SACC:

- dishonour, missed/late payment fee between $10-$45 (typically $30);
- default notice or arrears letters between $5 - $10 each; and
- monthly default account keeping fee between $10 - $25 whilst in default;

and more recently, as a direct result of Australia's Post's increase on 4 January:

- $1.50 postage cost recovery for priority mailing of any Default Notice.

We expect to see more of the latter being applied by other lenders as the 114% postage cost increase starts to bite. Not all clients charge each of these fees, however, and even if the contract allows for one or more of them, many do not charge it automatically as the Min-it Lending System has not been configured to do so as some systems have. Our clients will apply the fee, though, where it is obvious the consumer is merely avoiding their responsibility of repaying the debt.

In addition, we have not set the Min-it Lending system up to charge fees such as:

i. Nimble's $5 a day fee while in default which has been copied by a number of other lenders. Charged in addition to a dishonour fee, we believe this to be an unenforceable common law penalty and cannot be legally recovered. To our knowledge, ASIC has taken no action against any lender that charges such fees, however; or
ii. the charging of collection fees. Our contract requires the debt to be crystallised and a separate claim made to recover any debt collection fees.

Implementing a periodic payment cap by applying an arbitrary amount the lender can charge without any reference to its costs may either drive many out of the industry, resort to recovering some costs as enforcement costs or overseas. The latter is already occurring as we are aware that both Nimble and Cash Stop Financial Services Pty Ltd have established operations in the Philippines in a bid to reduce costs. It will be interesting to see what effect, if any, this has on their compliance costs.

When the UK decided to cap dishonour fees for payday loans at no more than £15, it did so only after the Financial Conduct Authority reviewed the books of every UK payday lender and ascertained a fair and reasonable amount to charge. Is the Panel going to recommend the same to the Minister?

As an attendee at the Melbourne meeting for SACC's, and I understand from one who attended the Sydney meeting, none of these options were even raised. It would have been good to have had some discussion about these as the effects need to be carefully considered rather than being a knee-jerk reaction.

<u>Option 4</u>

If the Panel wants to limit default fees and suggest a payment window of one payment cycle as per policy option 4, then we submit there must be full consultation by Government, both in respect of the entire credit industry and all other entities that charge such fees. There should be no discrimination of SACC lenders and it **must** apply **to all lenders,** including the ADI's. There must be no further diminution of contract law for SACC borrowers who choose not to adhere to the credit contract's terms and conditions.

Most SACC's are repaid either weekly, fortnightly or monthly depending on when the consumer receives their income or benefit payment.

In our opinion, if Option 4 were to be implemented, it would most likely lead to the majority of lenders taking little or no action during this 'no default fee' window, looking to try and implement weekly repayment cycles for all contract and a hardening of attitude against the non-payers after that. Cashflow is the lifeblood of any business and it would be unreasonable to expect a SACC lender to chase its debts without any recompense for a repayment cycle if it did not also apply to all other consumer credit products, whether ADI or otherwise.

It may also create major system issues, as what happens if the repayment schedule frequency is amended or the lender allows a repayment to be missed by arrangement?

Option 5

Unless Government is seriously going to look at every payday lender's – as opposed to every SACC lender's - book's and determine what fee could be charged, this is as bad as the when the original 10% establishment and 2% monthly fee was first floated and Government decided to double it. The author specifically asked Treasury to show what, if any, work it had undertaken to prove that lenders could be viable long term on a 20% establishment fee and a 4% monthly fee. It had not done any work at all and the figures were simply plucked from thin air. The figure of $10 per week, admittedly suggested as an example, may be an insult to some lenders that seriously chase those borrowers that go out of their way to avoid repaying their debt as if their costs can be justified, why would their higher costs not be deemed reasonable? Alternatively, if such a suggestion was to be implemented and the level of recovery is seen as being too low, what may eventuate are more debts being recovered via Court action.

As a former Credit Manager and trainer, it is spurious to suggest that the mere sending of an SMS will collect an outstanding debt and highlights a serious lack of comprehension of debt collection methodology and also of the technology suggested. Yes, an SMS will alert the borrower to the debt, providing they accept the SMS, but that does not mean they will then do anything about it. Unfortunately as well, not every SMS gets through for various technological reasons, not least because the phone is either switched off (perhaps deliberately or due to a dead battery) or the recipient is out of range and the SMS expires in the telco network's SMS Centre at the end of the validity period. How quickly the SMS message expires depends on the network carrier but it typically ranges from 5 minutes up to many days. Telstra's validity period, for example, is 7 days but other carriers are less than half of this. Alternatively, the mobile number recorded by the lender or given by the borrower may be incorrect and the intended recipient does not know of its existence.

Option 6

As the Interim Report notes, as the amount of debt falls, under this option, so would the recoverable fee. Many lenders typically have the last few payments dishonour because the borrower looks at the contract and believes the total due has been fully repaid as it contains either the date of the last repayment due or a schedule of repayments that shows this date and the amount due, conveniently forgetting any dishonoured repayments and any additional fees that the lender may have levied during the term. This option will seriously affect such lenders.

We are the opinion this option should not be implemented. Just as lenders have fixed establishment costs, so too are the default fees and we can see a way a fee based on the current balance could easily be manipulated.

Most SACC lenders do not pursue aggressive debt-recovery activities, though that might change if some of the options presented are implemented. Borrowers rarely risk any major personal or financial consequences (such as the recording of Privacy defaults) like those often associated with a default on a bank loan.

It is our opinion the consumer advocates are now trying to use the issue of a greater number of default fees being applied by SACC lenders as another method to try and close down the industry by suggesting limiting the number and amount of the fee that can be charged. Although the Interim Report states it "includes a range of possible policy options and, in some cases, a preferred option. The preferred options are not the Panel's draft recommendations[18]", we are extremely concerned with the way the Interim Report has been written. It appears its author(s), if not the Panel, appear to be listening mainly to the few consumer advocate submitters who, by default, only see those borrowers that are in dire

[18] Ibid 1, p.2

financial circumstances together with one major lender that charges below the current industry norms.

The consumer advocate organisations **never** see any of the silent majority of borrowers that do manage their financial affairs relatively easily. As an analogy, if a question was asked of a group of medical practitioners dealing with the Ebola virus, they would declare it would be a major issue as the only people they see have the virus. If the number with Ebola virus is taken over the entire world population, though, it is a very small percentage. The consumer advocates are no different. We are not demeaning the work they do as there are borrowers that have fallen into debt cycles but their claims, aided in part by a number of researchers with academic bias, are out of all proportion to the total number of borrowers.

We contend legislation should not be written around what one particular lender says it can do viably, even though that's what occurred when Government accepted Cash Converter's arguments and brought in the 20% establishment / 4% permitted monthly fee regime with the Enhancements Act. Without the redefinition of 'payday loans' as both it and we seek, Credit Corp may not be able to offer SACC's viably if some of these options were introduced.

The author, who has significant credit collection experience in three countries, believes none of the suggested options are either workable or fair. Lenders should be able to recover their reasonable collection costs from errant debtors up to the permitted twice the Adjusted Credit Amount maximum. ASIC already has the power to reel in those lenders that charge unreasonable fees. If any of these suggestions are implemented, we would envisage debt collection recovery costs will become enforcement costs and charged out in 6 minute increments, in the same manner that lawyers charge. That is ultimately going to lead to the consumer facing significantly more costs than they do now.

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.

<u>Option 7</u>

When the Enhancements Act draft legislation first came out, we invested substantial time and effort in changing our calculator to ensure it properly complied with it. The fact that the legislation was amended by the issuance of ASIC Class Order CO13/818 at the last minute required us alter what we had done in respect of recovering the direct debit fee but the system has always charged the permitted monthly fee due to the account on the same day of the month as the credit was advanced. From the outset, we also gave users of the Min-it Lending System the ability to reduce:

i. the establishment fee from the maximum 20% to 0% (but not exceed the maximum); and
ii. the permitted monthly fee from the maximum 4% to 0% % (but not exceed the maximum); and
iii. provided the lender the ability to hold or stop any further monthly fees from being applied, such as in the case of hardship;
iv. prevent the lender from creating a loan term of less than 3 weeks (longer than the legislated term of 15 days) or greater than 52 weeks; and

v. if there is no ledger balance outstanding on the monthly anniversary date, the fee is not charged,

all to ensure compliance. Additional compliance safeguards have since been added.

Some lenders have capitalised on the argument advanced by a well-known legal firm that states:

> "*[b]ecause interest does not run on SACC loan balances, it makes no difference when you debit the account, and that's why the legislation does not prescribe when you debit. The time for payment can still make a difference, because interest can run on arrears.*
>
> *The reason your contract is designed to debit monthly fees up front is to ensure the fee for the whole loan term is payable. Otherwise, if the monthly fee is charged monthly and the loan is repaid early, the fees not debited may be lost*."

These lenders have long earnt monthly fees they were not entitled to and the systems they use should be capable of complying with both the wording and intent of the legislation; we engineered ours to do so from the outset. We believe SACC consumers should benefit from early repayment of the balance, regardless of any fee splitting that may occur, just as they do for interest bearing loans as the permitted monthly fee was meant to be a fee in lieu of interest. For any loans that have payments split, that would require some significant calculator amendments and in all probability, it would be a further incentive for those lenders using that model to cease using it.

There are relatively few software suppliers in this country and a number of lenders chose automated systems without regard to whether or not the calculator was compliant. The Interim Report has suggested some alternative approaches, such as:

- "apply a discount to the monthly fees that could be charged according to the amount that was repaid, such as providing that the amount of the monthly fee reduces once 50 per cent or 75 per cent of the amount borrowed has been repaid;
- base the 4 per cent monthly fee on a declining balance; and
- in relation to situations where the consumer pays out a loan early — provide that fees can only be charged on a monthly basis, so that the consumer is not liable to pay the 4 per cent fee in respect of any outstanding months after they have repaid the outstanding balance.[19]"

We also note the Interim Report stated "[a]ny such formula would need to balance the outcomes for the consumer and the lender and should be simple to apply".

We are outraged at all of the options suggested. If we could get it right, so should they. The intent of the legislation, as advised by Christian Mikula to the Credit Industry Working Group, was that the fee should be applied on the same date of the month for each month (the "monthly anniversary") and we modified this to comply so that if the date doesn't exist in any month, the fee is applied on the first day of the following month. If there is no balance on the monthly anniversary date, the fee is not charged. That is the right way to deal with this and it's simple for the lender to apply. Options 1 and 2 still allow the lender using such systems to charge fees to which they aren't entitled and option 3

[19] Ibid 1, p.18.

could see errors occurring in the rebate calculation.

Option 8

We are in total agreement with the requirement for SACCs to have equal repayments over the life of the loan, while still allowing consumers the ability to pay off a SACC early. We have seen both Cash Converters use a two-tiered repayment amount over the term to limit the ability of other lenders provide finance and Money3 use an "other" (i.e., non-MACC) loan type to get around the additional SACC responsible lending requirements by having just two payments, one due after a week and the other at the end of 16 months. We submit both significantly affect the cashflow of the class of borrowers with whom they deal.

In regard to the question asked in the Interim Report "[t]o what extent do SACC providers charge fees in respect of outstanding months when a consumer repays a SACC early?[20]", we could not advise as our system does not permit any to be applied.

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.

We have long believed that leases are functionally different to credit contracts. It is difficult to comprehend how applying similar consumer protections to low

[20] Ibid 1, p.19.

value rental contracts may be differentiated from higher value goods. For example, we are aware of similar issues to some of the examples cited in the Interim Report for electrical goods with those applying in the ‘rent-to-own’ used car market. The only difference will be the cost price. When a used car over 12 years old worth no more than $1,500 on the open market is offered for sale on a rent to buy or lease option for $8,500 by paying what seems an ‘affordable’ $75 per week for just over 2 years, should not these also be included in any consideration for consumer protection?

<u>Option 9</u>

We see issues in determining what would constitute “low value” for some goods. Whilst we do not doubt there is evidence of consumer harm with many consumer leases, regardless of value, we remain of the opinion that the question of applying any cap should apply to **all** consumer leases and not just some alleged “low value” ones.

If all consumer leases were subject to the ACR maximum of 48%, which specifically excludes the application to SACC contracts under s.32A (4) (b) of the NCC, we can envisage an argument arising after the contract has been entered into with determining ‘cash price’. This is particularly so if the matter were referred to EDR and the legislation were to use something along the lines of paragraph 13(5) (b) (ii) of the Credit Act 1984 (NSW) as is suggested that states:

> *“(ii) where at the time the contract is made the goods are reasonably available for purchase for cash but are not reasonably available for purchase for cash from the person from whom the goods are hired—means the price at which, at that time, the person to whom the goods are hired might reasonably have bought goods of that kind for cash”.*

To provide an example, the author has been searching for a particular sized data cabinet recently and the price range of this item from internet searches and local enquiries ranged from $135 + $45 freight to $445.00 freight inclusive. Delivery ranged from within 4 days to 2 weeks. The quality and accessories supplied with the 14 items eventually selected for comparison ranged substantially but all looked identical and would have done the job. Consumer advocates consistently push the lowest price as the key parameter and I would expect them to try and argue the lowest price found should be the one used. In the end, I paid $325.00 for it, delivered in 4 days but using this example, there is clearly substantial room for an engineered dispute with establishing the value I "*might reasonably have bought goods of that kind for cash".*

Lessors deserve some certainty and any definition must also include references to quality and availability. Referring to a price charged by another retailer if that good is not available at the time should not be permitted. For this reason, we suggest the onus of proof of establishing the cash price in instances where the goods are not sold for cash by the lessor should lie with the lessee and not have to be defended by the lessor at substantial cost.

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.

We have already pointed out the incorrectness of stating there is an interest rate cap of 48% and have not checked the calculations shown in Table 3.

Option 10

One issue of the suggested cap is how some fees, some of which may be third party fees, like a delivery fee, are taken into account. As has been noted, for consumers living in rural or remote areas, a delivery fee may be substantial. The Min-it Lending System also handles consumer rentals and requires any such fees to be paid upfront in addition to the pre-payment of the rental so they are outside of any multiple calculation for the good. We are aware other systems do not take this approach and include them in the total periodic repayment amount so that they are recovered over the entire term.

All our rental system clients disclose any add on products or services separately and we consider it inappropriate to regard such fees as credit fees as the lessor is essentially performing a retail operation. We would envisage that if a fee outside of the base maximum ACR were applied to cover extra or upfront costs such as the reasonable cost of delivery, that fee would become the defacto amount applied to all leases which appears not to be the intent.

We suggest that no additional fee be applied to the ACR formula which is complex enough as it is but allow the charging of these fees **at cost** outside of the cap. If these fees were to be included in a cap, systems may need substantial amendment to ensure compliance and software suppliers would need sufficient time to make those amendments.

All the clients using our rental system capability currently do not offer leases of greater than 3 years, with the vast majority being of less than 2 years. We have discussed the issue of a maximum cap with a few of them but all indicated that as long as any term cap included up to and including 3 years, they would have no issue.

We have already stated that we believe any possible implementation of a cap affecting consumer leases should apply to all leases and further consultation is required.

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.

From what we have seen, there are major systemic issues with the way lessors comply with the responsible lending requirements and contract suitability obligations for **all** clients. The author has had discussions with a number of lessor's staff in regard to using our system and sadly, many clearly do not understand any of the legislation that affects them, be it NCCP Act, NCC or even Australian Consumer Law. The emphasis has been getting the 'sale' at any cost.

Option 11

As we have stated earlier, we dismiss the suggested 10% maximum of net income suggested in Option 3 as making the industry unviable and trying to apply an even lower maximum to consumer leases will do the same.

Our clients have indicated to us that it would be more appropriate to apply any cap on consumer leases independently to the cap applying to consumer credit. Their experience shows borrowers tend to manage the two totally separately. If consumer lease contracts were brought under a combined cap, every lender and lessee we asked stated the amount that could be recovered by way of a periodic payment will drop substantially. From a policy perspective, this might be the intended outcome but it may lead to the unintended consequence of greater crime locally. Three of our clients we asked for comment noted that crime in their local area has substantially increased as the ability to obtain finance has dried up for what is a growing number of borrowers. Financial exclusion may therefore become worse through applying such a cap.

Option 12

At the Credit Industry Working Group meetings, it was understood that the lessor could only charge what was outstanding up to the time the goods were returned or bought outright together with any early termination fee. What was probably not clear at the time was the majority of lease contracts would then claim the entire remaining balance of lease payments due as the early termination fee. We believe the regulator could have easily have taken action against all of these lessors that charge this way on the basis of it being an unfair contract term. In our opinion, such early termination fees amount to a penalty and unenforceable under common law.

We believe that lessees should be able to gain a benefit when terminating the lease early but we are aware this is also a difficult area as there are two separate issues here:

1. where the good is returned because the lessee no longer needs it; or
2. where the lessee wants to acquire the good prior to termination of the lease.

Return of goods

Prescribing a maximum here could incur a loss for the lessor. An example of this was one of our clients had a fridge freezer that cost $2,200.00 leased for a term of 3 years. The lessee moved but found they could not take the fridge freezer with them so they wanted to return it when the lease had not yet run 12 months. After a field call to the client that cost $66.00 (including GST) to ensure it was worth uplifting, as the client was located some 134 km away in a rural area, a commercial delivery company was arranged to pick it up and return it to the lessor at a cost of $250.00 (including GST). The fridge –freezer was then found to require substantial cleaning and that took 2.0 hours of a staff member's time. Based on that staff members' hourly rate, that amounted to $50.00. With other communication and courier costs involved in arranging to collect it, store and advertise the item for sale, these additional costs amounted to another $72.00.

In total, it cost this lessor $438.00 to pick up and dispose of the item which was eventually sold for $840.00. Without the claim for depreciation, this could have been a substantial loss to the lessor. We are not suggesting these kinds of costs apply in every event but it does go to show that what might seem unreasonable isn't necessarily the case.

Prescribing a maximum amount that can be charged on termination will be fraught with difficulty and it is suggested these be limited to actual and reasonable costs. In many cases, there are no additional costs and so having to itemise and justify these as a claim, in the same way that must be done for the sale of goods after repossession, would be appropriate.

Acquisition of goods

When a lessee advises the lessor that they want to acquire the good being leased, we believe there should be no additional early termination fee able to be charged. What could be charged instead is a residual based on any unpaid principal to that point in time rather than tying it to the amount of any outstanding lease payments due. Most lease contracts currently do not include a residual amount. A system should be able to calculate this value providing the purchase details have been entered correctly.

Option 13

We agree that providing 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 is a possibility but both the ACCC and ASIC already have the power to act. We have no issue with strengthening either the NCCP Act or NCC though.

None of our clients have a level of discount shown in their lease contracts for early termination and nor do they provide a different discount attributable to a future lease.

If the Review Committee would like further clarification on any matter raised in this submission, the author would be happy to answer any further questions.

Appendix 1

Loans

Description	#[1]	Frequency Description[2]	Frequency Duration[3]	Frequency Amt $[4]	Total Debit $	Total Credit $[5]	Monthly Amt $
FERRATUM LOAN (DEP INT)	1	Once-Off	21Oct	500		500	
NIMBLE BFI SHEARN (DEP)	2	Infrequent 26 Days	12Nov - 8Dec	160 (120-200)		320	
MONEY 3 SE MONEY 3 (DEP)	1	Once-Off	24Nov	200		200	
FERRATUM (DEP INT)	1	Once-Off	25Nov	200		200	
MONEY ME MONEY ME (DEP)	1	Once-Off	1Dec	250		250	
SPEEDY MONE SPEEDY MONEY (DEP)	2	Infrequent 1-2 Months	1Dec - 4Jan	350 (200-500)		700	
CASH CONVERTERS (DEP)	1	Once-Off	2Dec	400		400	
FINANCIER PTY LT (DEP)	1	Once-Off	10Dec	200		200	
SUNSHINE LOAN CE (DEP)	1	Once-Off	15Dec	150		150	
STRESS LESS MONE (DEP)	1	Once-Off	16Dec	300		300	
CCPF CR (DEP)	1	Once-Off	23Dec	500		500	
MONEY MONEY ME (DEP)	1	Once-Off	30Dec	550		550	

[1] Denotes number of deposits made

[2] Denotes frequency of deposit(s)

[3] Denotes dates of deposit(s)

[4] Denotes amount or amounts of each deposit and if more than one, average deposit

[5] Denotes total amount of credit received