Interim Report Response -

REVIEW OF THE SMALL AMOUNT CREDIT - CONTRACT LAWS -

22 January, 2016

To: - SACC Review Secretariat
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INTRODUCTION -

We welcome the opportunity to make a further submission to the Review of the Small Amount Credit Contract laws, and thank the Panel for this opportunity.

For the benefit of the Panel, we reiterate that we are predominantly a SACC lender (78.5% of contracts), with the balance of business being in MACC provision. By dollar value SACCs accounted for 64.77% of funds advanced, while MACCs accounted for 35.23%.

All of our credit contracts are offered over longer terms that the industry average - SACCs are calculated on a nominal nine month repayment term. Our business is what used to be known as a 'microlender' before the advent of SACCs and MACCs. We do not, nor have we ever, engaged in the type of loans which are pejoratively labelled as 'payday' loans.

We do not offer consumer leases, and have no expertise in that area. Accordingly, we have restricted our comments purely to the issues relating to SACCs.

We consider the overall remuneration for a SACC (at 20% establishment and 4% monthly, maximum) to be insufficient overall, that allowable establishment fees are insufficient to cover costs in at least the majority of instances, and monthly fees do not provide a sufficient return for the effort and risk of the lender.

It is clear that public and charitable bodies are unwilling or unable to adequately service the sector, and banks are unwilling to do so either. Given that private entities are necessary to fulfil the demand, and government's acknowledgment that the industry should persist, then government must ensure that private lenders can remain economically viable.

As stated at the time of making our initial submission to the Review, we would welcome any opportunity to be of further assistance. The viability of our industry is obviously an issue of huge import for our business, the families who rely on it to earn their living, and our customers.

We appreciate the short time frame left before the reporting date falls due, and thank the Panel for their work to date.

CONCERNS ABOUT THE INTERIM REPORT -

While we appreciate that the Interim Report is the Panel's initial observations and does not make any recommendations, we hold some grave concerns about the efficacy of the Review as a whole based on our reading of the document.

Scope of the Review

Our understanding of the legislated review (as provided by section 335A of the *National Consumer Credit Protection Act 2009 (Cth)*) was that it was to relate to SACCs. We understand and appreciate that the scope of the review was enlarged by the Minister to look at recommendations whether SACC provisions should be extended to consumer leases. However, the Review should be predominantly concerned with SACCs.

We are therefore dismayed to see that a significant a portion of the Panel's attention seems to be devoted to the issue of consumer leases. Since the provision was enacted, we have awaited this Review as an opportunity to see the difficult SACC provisions hopefully moulded into something which is commercially workable.

Our comments are not intended to make any form of claim that the issues concerning consumer leases do not warrant attention. Instead, our apprehension is that the Review of the SACC laws is being usurped by a separate issue which may ultimately overshadow the original intent. The large and expansive scopes of each issue and the impending due date for the Panel's report only increase our apprehension.

Reliance on outdated and incorrect information

We have already brought to the Panel's attention our concerns regarding the information espoused by an anti-industry consumer advocate (by which we refer to our letter to the Panel Chair dated 30 October, 2015). The degree to which such information has been taken into account by the Review is unknown, and we have not received any further contact about our concerns.

What is clear in the Interim Report is that the Review is relying to a certain extent on the ASIC's Report 426 '*Payday lenders and the new small amount lending* provisions'. Our first submission calls attention this report's reliability into question (see pages 6 and 7), and we are well aware that other parties have done likewise. To recap some of the concerns regarding Report 426:

(a) ASIC uses the term 'payday lenders' to describe the whole SACC industry, which is incorrect, misleading and reputation damaging. We again point out that the term 'payday loan' has no legislative substantiation. It is an ill-fitting, appropriated term which is both inaccurate and prejudicial. It is bad enough that anti-industry proponents and media use it to demonise the industry. It is far worse to have our regulator inaptly tar all of industry with the label;

(b) Report 426 is solely based on information gleaned from a small number of SACCs created in a two week period in 2013 – barely several weeks after the implementation of the very legislative provisions that were being scrutinised, when industry was still finding its feet with new and novel regulatory requirements;

(c) ASIC states that it purposely selected lenders with a higher risk of non-compliance with responsible lending and disclosure obligations. This clearly indicates that the findings of the report are biased and cannot be relied upon as indicative of industry as a whole;

(d) Comments in the report point to the real possibility of a failure by ASIC in its research methodology – reporting on SACCs but stating they identified credit contracts with loan terms set at greater than 12 months. By legislative definition, any credit contract with a term of more than 12 months cannot be a SACC and, therefore, should not have been considered in the report; and

(e) The information was over a year and a half old when the report was published, but is somehow being referred to as current data by multiple parties. The Interim Report falls afoul of this a number of times.

In short: ASIC Report 426 is unrepresentative, is not current information and was garnered from a statistically small, biased sample of contracts which were created before the ink on the laws by which they were judged had dried. Relying on its information as representative of industry as a whole (current or otherwise) is insulting.

<u>Perceived failure to acknowledge commonly held concerns about the legislation</u>

Our review of the submissions to the Review indicates two themes which appear numerous times throughout both 'sides' of the argument[1]:

(i) The current SACC provisions are complicated and confusing for all concerned; and
(ii) The SACC provisions are not being fully complied with.

We see no acknowledgment in the Interim Report, in either tone or content, that these issues have been given due consideration by the Panel. For example, Observation 2 calls for increased regulation - but this observation cannot credibly be made if apprehensions about whether the current regime is properly implemented are given serious consideration (particularly when some of those apprehensions are held by parties whose sole focus is consumer protection).

[1] For example, we refer to the submissions of the Australian Financial Conference, Care Inc, Consumer Credit Legal Service (WA) Inc, K&L Gates, Law Council of Australia, Min IT, Nimble, Policis, and Redfern Legal Centre. We also note the comments in the September discussion paper of the Review.

SPECIFIC RESPONSES TO THE OBSERVATIONS -

Our comments here are:

- Restricted to Observations 1 to 5, as the balance concern consumer leases; and
- Are of a general nature. Specific comments are contained in response to the Interim Report's options and questions (below).

Observation 1

We agree with the Panel's observation, and point out that a viable and functioning SACC industry is an essential part of that outcome (as well as being a stated policy aim of the government). The SACC industry's demographic – both in terms of product provision and a significant proportion of its customer base – is not adequately serviced elsewhere in the financial market.

Observation 2

Further to our previous comments, it is inaccurate and premature to claim the current regulations are not sufficient when they are neither operating correctly nor properly policed.

It is ironic to claim additional regulation is needed while acknowledging, in the very next sentence, that enforcement of the current regulations may not be up to scratch.

Regulations only work if they are both capable of being clearly interpreted and properly regulated. With SACCs, neither requirement is achieved. In our view, the Review's aim should be to seeing both requirements are met before advocating additional regulation. To do otherwise would only result in an even bigger mess as lenders are faced with a greater range of complication, which will still be improperly enforced. This cannot be an acceptable outcome for any interested party.

Observation 3

The bulk of this observation does not appear to be supported by anything greater than a cursory view of the marketplace; indicated by the repeated use of the word "appears". Much of the damage already caused to the SACC industry stems from reactions to appearances without proper consideration of relevant factors (the current cap, for example, being implemented without understanding the real cost of production).

We caution the Panel against making superficial observations as they have a tendency to quickly become findings of fact; and, in this realm, usually to the SACC industry's detriment.

The exception in the observation is the perceived failure of the rebuttable presumptions. We agree with this sentiment, but our view as to why this has occurred is down to the complicated regulations and the failure to properly police them; not with the mechanism itself.

Observation 4

We agree the total cost cap is an important safeguard for consumers, and it is a provision we endorse.

Caution should be had when extrapolating the conduct of some lenders against the whole of industry, when considering the way in which default charges are levied (if at all). The Code already contains provisions which address this sort of conduct. In line with our previous comments, these provisions should be properly enforced before any consideration should be given to additional measures: especially those which have to capacity to negatively affect lenders who are properly complying with current regulation.

In addition, there are safety net measures already in the Code to protect disadvantaged and vulnerable consumers – namely the total cost cap itself.

Our experience, however, is that most defaulting consumers are either not disadvantaged nor vulnerable, or use their actual situation as an excuse to make no effort to repay their SACC at all. The vast bulk of chronic defaulters are actively evading their credit contracts and making no attempt to pay their debt. We refer the Panel to the information contained in our first submission, particularly at pages 34 to 43.

Observation 5

We are not surprised that some lenders are seeking to maximise their returns in the face of the very questionable viability industry is faced with. Our understanding is that the activities referred to are within the bounds of the law. In this regard we note one of the initial goals of the Consumer Credit Code (as the precursor to the *National Credit Code*) was that "*competition and product innovation must be enhanced and encouraged by the development of non-prescriptive flexible laws*"[2].

The observation appears to be framed that such actions by lenders are improper. Such a sentiment is unfounded; apparently expecting that lenders should share the same moral outlook as consumer representative groups. Such a viewpoint is fundamentally untenable, considering that some consumer groups actively campaign for the eradication of SACC lenders[3].

The form of the existing cap specifically allows for the charging of the monthly fee – not a daily fee, or a weekly fee. It was acknowledged that a reducing charge based on the outstanding balance, at or around the 48% per annum mark, was insufficient to allow for continued commercial viability.

Our initial submission referred to a document received under Freedom of Information from Treasury, dated 5 June 2012[4]. The same document provides information about the design of the 4% monthly fee:

[2] The Hon. T J Burns, Minister for Consumer Affairs (Queensland), second reading speech for the Consumer Credit (Queensland) Bill, Queensland Hansard, 4 August, 1994 (at pages 8828-8829)

[3] For example: see the submissions of Consumer Action Law Centre at page 4 (stating that they do not consider that SACC lending (termed 'payday') is a useful or necessary part of the consumer credit market), and Financial Rights Legal Centre at pages 3-4 (calling for SACCs to be banned).

[4] Annexure 3, Document 8 to our initial submission, "*Summary of Main Changes to Reforms in Relation to Small Amount Credit Contracts*".

"***Concerns as to how the 20/4 cap operates in practice***

Some lenders have raised concerns as to how the 20/4 cap operates in practice, as both the 20% upfront fee and the 4% monthly fee are calculated on the adjusted credit amount, which excludes the establishment fee. It is argued that this does not allow credit providers a return on their establishment costs.

The 20/4 model is based on fees rather than interest, so that the comparison with a credit contract, in which interest can be charged on establishment fees is not relevant. For example, the use of fees means that the consumer does not get any benefit from making repayments early. While the 4% fee is calculated on a sum that does not include the establishment costs, it still provides a return that is intended to cover those costs in dollar terms, and is higher than the 48% interest rate would allow."

This explanation shows the flat 4% monthly fee was considered a form of 'compensation' for lenders because of the nature of SACCs, for example: being unable to receive any form of compensation for deferred payment of the establishment fee.

Our clear and stated opinion is the existing cap is insufficient to ensure continued viability. Further degrading the returns of lenders obviously does nothing to improve the outcome.

It is also clearly contrary to government's rationale in designing the cap in the first place.

COMMENTS CONCERNING SOME SPECIFIC STATEMENTS IN THE INTERIM REPORT -

Page 5: "*More SACCs are being provided online..."*

We don't dispute more SACCs may be being provided online, but don't necessarily agree it is as a result of improvements in technology.

Our lending operations were founded on providing services in 'bricks and mortar' outlets, so that we could meet with consumers, discuss their needs and get a better 'feel' for our customer.

In 2015, we ceased operating in this manner and transitioned to a solely online business model. We were able to do this because of improvements in technology, but we did not do it because of those improvements. Rather, the shift was prompted solely in an effort to decrease costs and remain in business.

We simply were not able to continue to bear the expense of operating a number of physical outlets and remain economically viable. We would be surprised if other lenders have not had similar considerations in revising their business models.

Page 8: *"Academics have also noted that the reliance on responsible lending obligations is not in itself sufficient."*

We point out the provisions currently applying to SACC lending go well above and beyond 'responsible lending', despite being collectively labelled as such. These include:

- Mandatory and enforceable external dispute resolution;
- Licensing;
- A comprehensive civil and criminal penalty regime, including strict liability offences;
- Mandatory National Credit Code requirements in relation to documentation and information provision;
- Extensive hardship provisions;
- Costs and total cost caps; and
- A restrictive category for SACCs, including maximum terms and inability to take security for the debt.

Ignoring these factors is unacceptable when considering further reform.

Page 8: Quoting of figures concerning complaints about responsible lending and unjustness

We caution the reliance on any figures concerning the number of complaints about lenders. We are well aware, and pointed out in our initial submission, of a pervasive campaign by consumer advocates against the SACC industry[5]. Part of this campaign involves the funnelling of as many complaints as possible to the two external dispute resolution schemes.

Added to this, the external dispute resolution bodies tend to be biased against industry by their very nature. They are dispute resolution schemes created as a service to consumers, and their decisions

[5] As a prime example, we refer to pages 61-62 of our initial submission which detailed the plan by the Financial Rights Legal Centre and Legal Aid NSW to do exactly that.

are binding on lenders - but not on consumers. Failure to comply with their directive jeopardises the lender's ability to remain licensed. The more involved a dispute handled by them becomes, the more it costs the lender; a cost they cannot pass on. Therefore, their basis (without having to take any action) pressures the lender to acquiesce in favour of the consumer. This is especially so for SACCs, because the cost of accepting and looking at a dispute is much greater than the gross profit margin of the average SACC[6].

If this wasn't bad enough: the scheme which predominantly services the SACC industry, the Credit & Investments Ombudsman, obviously has little regard for its members. In forming its submission to the Review the scheme made no discernible effort to canvas its members for any information (relevant or otherwise). It also strongly appears they are in favour of disadvantaging lenders and customers by restricting lenders' ability to do business. The CIO advocates: replacing the rebuttable presumption with an outright ban[7], clearly failing to consider how this will affect their members' businesses; and stifling innovation by calling for broad anti-avoidance provisions[8].

Pages 9 & 10: Suggested costs of establishing SACCs

The commentary surrounding this subject appears to be disjointed from the inferences. Further, the inferences appear at odds with each other (considered in the policy option comments below).

The issue we raise here is the suggestion "*the average acquisition cost for a successful customer is around $200 with about two-thirds of this cost relating to advertising."* We question the veracity of such a statement and point out that no reference or justification is given.

Quantum aside, it is inferred the cost of 'customer acquisition' forms part of the establishment fee of a loan. Whether it does is debatable, and an automatic inference that it does form part is presumptive.

Assuming that the cost of establishing a repeat loan is somehow "significantly lower" marks a dangerous exercise in attempting to justify a decrease in allowable establishment fees. It has already been acknowledged that the establishment of a SACC involves significantly more regulatory 'hoop jumping' that other forms of consumer credit. Establishing the identity of a customer is a small part of the overall compliance needed. The assumption fails to give consideration to the extent required to correctly establish each and every loan in compliance with the legal requirements.

The sentiment is further questionable given the comment made shortly thereafter in the paper: "*evidence suggests the maximum establishment fee appears not the cover the cost of acquiring a new customer for the majority of SACCs."* Even if we accepted the assumptions leading to this statement; it is preposterous to propose leaving an inadequate charge in place while reducing a

[6] For example: the Credit & Investment Ombudsman's fees for Registration and Initial Review is currently $545. The average SACC ($500 for 90 days) has a maximum gross profit margin of $160 (20% establishment fee, plus three lots of 4% monthly fees).

[7] At pages 2 to 3 of CIO's submission to the Review.

[8] At page 3 of CIO's submission to the Review.

subsequent charge, after effectively observing that it appears the subsequent charge may in part be making up for the loss of the first inadequate charge.

Page 15: Assertion the Credit Act does not regulate aspects of fees

In considering default fees, the Interim Report states the Act does not regulate their rate, type or recovery. This is patently incorrect, because:

(a) As to the rate: There are three provisions in the *Code* which limit the rate of default fees under a SACC:

(i) Section 39B provides the total amount recoverable under a SACC is twice the adjusted credit amount. This necessarily includes, and therefore limits, default fees (with the exception of enforcement expenses);

(ii) Section 78 which provides a court may annul or reduce an unconscionable 'charge'. We note the use of the phrase 'establishment fee or charge' in the legislation is confusing, but point out: the term 'establishment fee' is used and recognised in the *Code,* while the phrases "establishment fee or charge" and "establishment charge" are not used anywhere else in the legislation. Accordingly, it is entirely open to a court to determine that the references to 'establishment fee' and 'charge' in the provision are separate; and

(iii) Section 107, which relates to enforcement expenses (a subset of default fees). It provides that a credit provider cannot charge more for an enforcement expense than the cost reasonably incurred by the credit provider;

(b) As to the type: Section 31A of the *Code* clearly provides that only certain types of fees may be charged under a SACC. As well as establishment, monthly and government fees:

"a fee or charge that is payable in the event of default in payment under the contract." [emphasis added]

This clearly shows that only default fees arising from payment default may be charged - as distinct from a default in another obligation under the credit contract; and

(c) As to recovery: The Code regulates the steps that must be completed before a credit contract may be enforced – such as the requirement to send a compliant notice under section 88, and waiting a mandatory time period. This is in addition to the recovery aspects of the sections referred to in (a) above.

While we agree that the Act doesn't specifically regulate how a SACC provider recovers the funds, there are general controls throughout Australian law which regulate the operation of contracts (such as the provisions regulating standard form contracts in the Australian Consumer Law).

Page 15: Defining 'default'

The comment as to the interpretation of the word 'default' infers that it is some arbitrary concept. Credit law is fundamentally contract law and, since 'default' is not a defined term in the legislation, then the ordinary, established meaning of the word should be used.

Simply put: if a party is required to fulfil a condition by the terms of a contract (such as a requirement to do or refrain from doing a particular act), then failure to comply with that condition constitutes an act of default of the contract.

Accordingly, what is a 'default' will depend on the legal terms of the contract in question. By way of simplified example: if the contract states it is an act of default if a party does not pay an amount on or before a particular date, then failing to make pay that amount by the end of the required day is an act of default.

This stance is supported by the construction of the *Code*. Section 88 sets out the requirement to send a default notice before enforcement can take place. It provides a notice of default:

(a) may be sent when a debtor is in default under the credit contract; and
(b) must state what action is necessary to remedy the default.

This clearly aligns with the legal concept of a contractual default.

Page 15: Noting concerns by some in the way SACC lenders charge default fees

We do not necessarily disagree with the comments about the perceived reasoning behind the rationale of some lenders (except perhaps the failure to state that the reasons are 'claimed', since they are not conclusively determined).

However, the failure to consider that it may be necessary for lenders to act in particular ways because of the insufficient returns afforded under the cap is glaring. The same can be said for the failure to countenance the position that borrowers failing to pay their SACCs significantly jeopardise the viability of lenders – both in terms of cash flow and profitability.

Lenders have effectively no protection from defaulting borrowers, and little real ability to enforce the contract as it is. They are further forced into undertaking work for free because of the restrictions on the type of fees and amounts that can be charged. In this we refer specifically to such events as dealing with hardship notices, (unfounded) complaints, listing credit defaults and SACCs which have reached the total cost limit.

It is therefore unsurprising that lenders have employed novels ways to operate. And, if they do so in a manner which is not inconsistent with the law, careful scrutiny should be given before moving to remove this ability to do so.

RESPONSES TO REQUESTS FOR FURTHER INFORMATION

1. - **Information on trends**

We have no further information to provide as this time beyond that already submitted to the Review in our initial submission.

2. - **Options 1, 2 and 3: Establishment fees, repeat borrowing and protected income**

2.1 - **Option 1: Reducing the establishment fee for 'returning customers' to 10%**

The two initial premises in this option give us great concern:

(a) "*The cap on establishment fees does not appear to align with the actual expenses incurred by lenders".*

This claim could be interpreted as the allowed fees are higher than the costs, or vice versa. It is clear from the Interim Report that the Panel considers it to be the former; which is premature, unwarranted and incorrect.

We agree it does not align, but for the reason that costs are (most often) higher than the fees allowable. As we have stated previously, no research has been published which demonstrates the true cost of establishment of a SACC. This point is serially ignored, and woefully so.

Rather than rehash arguments already presented, the following factors should prove to summarise the major concerns with premise:

(i) The cost of establishing a SACC is independent of the amount lent - but the establishment fee is not. How can a blanket claim be made that the fees are too high, when the amount realisable can practically be as little as $20?;

(ii) On the claimed average SACC of $500, the maximum charge for an establishment fee is $100. What justification proves that lenders can comply with all legal requirements to establishment a SACC for under $100 (let alone a lesser figure)?; and

(iii) The Panel (and other commentators) make repeated comments SACC providers do not appear to be fully complying with the responsible lending requirements. If that is true: are the perceived costs of establishing a SACC based on what is actually needed to fully comply, or on what substandard actions lenders are alleged to perform? If it is the latter, what research demonstrates the true cost of complying with the current requirements?

(b) *"Several stakeholders noted that there is a lack of competition on price in the industry, with most SACC providers charging the maximum amount of establishment fees for subsequent loans even through the fees does not reflect the actual costs."*

This statement is premised by reference to submissions by the Consumer Action Law Centre and Credit Corp.

Consumer Action Law Centre claim "*competition between large lenders* [is] *failing to reduce fees and charges*" and "*price competition does not work in this market*"[9], but fail to countenance that the ability of competition to reduce price is constrained against underlying cost. We note that we have raised strong concerns with the Panel regarding incorrect and unjustified information in Consumer Action Law Centre's submission.

Credit Corp's submission merely acknowledges that "*one of the common arguments for regulation of the SACC sector is the absence of competition*"[10]. This is not a claim by Credit Corp, but rather a reference to claims by others. Coincidentally, the reference in Credit Corp's submission in this regard is to a submission paper by the Consumer Action Law Centre! [11]

Neither submission (at least at the places referenced) makes any claim that the fees do not reflect the actual costs. In this regard, we refer to Credit Corp's submission where they state[12]:

"*21.2 ... We leverage our existing infrastructure to marginally cost overheads to the lending business.*

...

21.6 Credit Corp does not advocate a reduction in the fee caps. We recognise that other operators may have differing operating models which deliver an alternative consumer experience and may not be able to continue at our pricing structure. Credit Corp's lending business has been refined over several years' operation and with considerable investment. Applying reduced caps may stifle the ability of new entrants with more innovative models to commence in the SACC sector to the ultimate long-term benefit of consumers."

Credit Corp proclaim that they lend at charges below the maximum allowable at law. From the above, it is clear they have been able to do so because of their size and by applying infrastructure and processes which were paid for out of other aspects of their business. Or, in other words, it's a loss leader for them - the return from Credit Corp's SACC lending is not being measured against their true cost of producing the loans. This admission should ensure that any claim of costs or returns regarding SACCs from Credit Corp is disregarded as unrepresentative.

Our stance is there is no real ability to compete on price because lenders are already forced to rely on subsistence returns. The ability to compete on price requires a sufficient margin of price over cost (ie 'profit') within which to move; unless the lender is willing to take a loss, often offset against other revenue or assets and usually in the hope of future profitability.

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[9] Consumer Action Law Centre submission to the Panel, 15 October, 2015, at page 7.

[10] Credit Corp Limited submission to the Panel, 15 October, 2015, at page 7.

[11] Reference to Consumer Action Law Centre, Submission to Parliamentary Joint Committee on Corporations and Financial Services, 14 October, 2011, per page 28 of Credit Corp's submission (reference item 4).

[12] Credit Corp's submission, at page 24.

Competition in other areas is further constrained because of the restrictive, homogenous nature of SACCs. Lack of profitability also acts here because the need to decrease costs creates downward pressure on the scope and quality of attendant services.

We contend the real incentive for SACC providers to encourage repeat borrowing is because it is less risky and the costumer has a degree of knowledge about the processes (ensuring they run smoother and quicker). The communication between the parties will be better because of familiarity. This leads to each party having a better understanding of what is required, and how the other party will act in particular circumstances. Essentially, it reduces the fear of the unknown.

If there is any increased profitability in loans to repeat customers, it is not because the administrative processes themselves are significantly less (which they aren't) - it's because they can take less time and effort to perform. There is no justification for the comment that "*upfront administrative costs are significantly lower*", and that view fails to consider the practical realities of the responsible lending obligations.

The only practical difference in terms of SACC establishment between a first time borrower and a repeat borrower is that their identity is already established.

A lender must still establish suitability of an intended repeat SACC for the consumer, and in doing so comply with the various regulatory requirements. We refer the Panel to Table 4 of our initial submission (either page 32 or 73) in this regard. Only one step of the table may be dispensed with for a repeat customer, and that requirement is from a separate piece of legislation.

There may be a perception that a credit assessment made less than 90 days prior can be relied upon again - but it is a false perception. The practical reality is a consumer's financial situation can change within the space of one day (let alone 90) in areas that a SACC lender must be assured of before providing a SACC. Any lender which seeks to rely on an existing assessment does so at their peril.

In summary we consider this option to be a poor consideration, which is not credibly justified. We have previously stated in our initial submission that the 20% establishment fee is insufficient to adequately compensate lenders for the cost of establishing a SACC. Reducing the achievable amount will only hasten the demise of the industry.

2.2 - Option 2: Replacing the rebuttable presumption of unsuitability for 'two or more SACCs in the past 90 days' with a prohibition

Our stance is unchanged: we do not consider an absolute prohibition to be suitable. Absolute prohibitions are blunt objects that only serve to create further problems; some of which are set out in pages 19 and 20 of our initial submission:

(a) If the repeat SACC would be suitable for the consumer in accordance with their financial situation, a prohibition would only deny them a product which is suitable according to their situation;

(b) It creates a further divide between SACCs and every other finance product available in Australia; and

(c) Anti-competitive behaviour would be supported, by enabling a lender to 'lock in' a consumer so that no other lender could provide then with a SACC in any particular 90 day period.

The ability to protect ‘vulnerable’ consumers is already apparent in the legislative mechanisms, but these mechanisms are simply poorly constructed and ineffectively policed. We do not consider it suitable that lenders and borrowers be disadvantaged in having to suffer an absolute prohibition because of these failings.

Repeat borrowing is not the problem. Complex and imprecise legislation which is not effectively policed is the problem here. Fixing the problem will result in a reduction of unsuitable repeat borrowing; thereby providing the apparent intended outcome but without negatively affecting those doing the correct thing or the capacity of consumers to obtain services.

2.3 Option 3: Capping the amount that may be used for repayments to 10% of net income

A measure such as this is not necessary, because the proper mechanisms are already contained in the law.

Lenders must calculate affordability commensurate with the applicant's financial situation. It does not matter what figure is arbitrarily considered. If a proper assessment of the consumer's financial situation shows they can afford 5% of their net income in repayments - that's the maximum that they can properly be expected to pay. All implementing this type of cap does is restrict the ability of consumers, who can demonstrate greater affordability, to obtain larger SACCs.

If a lender should fail to properly consider affordability, the legislation provides sufficient sanctions and consumer protections (if properly implemented).

Consider the following table which is based on our usual SACC lending arrangements. Our SACCs differ from the industry 'average' : our average adjusted credit amount is $1,100 and the term is 8 to 9 months (both of which are considerably greater than the average ‘$500 for three months or less’).

The figures in the table are calculated on our average SACC repayment term and the mooted 10% income cap.

Table 1: Effect of 10% on income/repayment cap -

SACC Adjusted Credit Amount	Repayment Amount per Week	Net Income Required
$300	$12.75	$127.50
$400	$17.00	$170.00
$500	$21.25	$212.50
$600	$25.50	$255.00
$700	$29.75	$297.50
$800	$34.00	$340.00
$900	$38.25	$382.50
$1000	$42.50	$425.00
$1100	$46.75	$467.50
$1200	$51.00	$510.00
$1300	$55.25	$552.50
$1400	$59.50	$595.00
$1500	$63.75	$637.50
$1600	$68.00	$680.00
$1700	$72.25	$722.50
$1800	$76.50	$765.00
$1900	$80.75	$807.50
$2000	$85.00	$850.00

For the sake of argument, we'll assume the average annual income of SACC borrowers in 2015 is $35,702 (as postulated by Digital Finance Analytics in their submission to the Review, at Table 26 on page 22). This equates to a net weekly income of approximately $609.58. Implementing the 10% repayment cap would have the effect of:

- Precluding the average person from obtain a SACC from us if the amount required is between $1,500 and $2,000;
- Restricting the borrower to only one SACC (assuming equal amounts), unless both SACCs have adjusted credit amounts of $700 or less; and
- If the borrower obtains our average SACC of $1,100, they may have a maximum second SACC of $300.

Given that our SACCs are over a significantly longer repayment term, their repayment amounts are much less than the usual SACC. This means the problems identified above are magnified when considered against the 'usual' SACC. Implementing this sort of measure will undoubtedly see the situation where the law allows SACCs of up to $2,000 – but no one is allowed to have one because of a cap on the income that may be used for repayments.

2.4 Answers to specific questions

2.4.1 If the ambit of this question is whether option 2 or option 3 should be joined with option 1 (as postulated), then our answer is simple: it will only be effective in killing the industry. Option 1, by itself, will accomplish that outcome.

If the ambit is simply a consideration of option 2 versus option 3, option 2 is probably the more flexible one for industry and consumers, as option 3 is likely to restrict consumers to one SACC only at a time and also restrict the amount that that SACC can be (for the reasons shown above in the consideration of option 3). We still do not, however, consider either option 2 or 3 to be suitable.

2.4.2 No cap is suitable, given that any amount would simply be an arbitrary figure which derogates from the purpose of assessing suitability under the responsible lending obligations. It further excludes consumers from their own financial reality and that of the rest of the credit market by creating an artificial 'bubble'.

2.4.3 As stated, a properly assessed loan is either affordable or it is not; regardless of what individual payments are because a proper assessment will necessarily have taken them into account. That is the 'broad measure' that is relevant.

2.4.4 This suggestion simply appears to be a way to further constrain and complicate an already unnecessary proposal.

3. - **<u>Options 4, 5 and 6: Default fees</u>**

3.1 - **Option 4: Introducing a 'default window' before default fees may be charged**

The premise of option 4 appears to be that all 'default' fees are the same, when this is simply not the case. A default, to paraphrase our earlier comments, occurs when the borrower fails to comply with a contractual obligation, with or without a timeframe. Most relevantly, this is the making of a repayment on or before its due date – often being a series of obligations equal to the number of contracted repayments.

Rather than draw on a hypothetical range of fees, some of the actual fees we commonly charge under a SACC are:

(a) *DDR dishonour fee*. This is the amount charged by our direct debit provider company when a direct debit request dishonours;

(b) *Debt collection fee*. This includes a range of fees we may incur in enforcing a SACC, such as the cost of sending a commercial agent to conduct a field call or the cost of filing legal process;

(c) *Default notice fee*. Our cost of preparing a sending a notice pursuant to section 88 of the *Code*; and

(d) *Telephone call fee*. Our fee for contacting a borrower by telephone where they have defaulted on their SACC; done in an attempt to get them to comply with the terms of the SACC.

It is unlikely that (b) will factor into this consideration due to the time frames necessary before undertaking debt collection, so we'll discount that one.

Consider a SACC borrower contracted to make weekly repayments by direct debit, and their first and second direct debit attempts dishonour. The following steps then occur:

(i) We must send a notice to the borrower because a direct debit default occurred[13]. This must be sent within 14 days[14] of the default occurring;

(ii) It is arguable that another notice of direct debit default must be sent for the second dishonour, because the wording of section 87 is slightly ambiguous and there has been no judicial determination made. Since failure to comply is a strict liability offence, incurring a criminal penalty, prudent lenders should act accordingly and send another Form 11A;

(iii) A *Code* compliant default notice should be sent to the borrower[15]. While it is not a strict necessity to send the default notice, the SACC lender can never enforce the contract if they fail to do so. The notice must be physically posted[16] and contain specific information, including a Form 12A. Attaching the Form 11A (direct debit dishonour notice), this means a minimum of three pages for each default notice when factoring in *Code* requirements for notice formatting[17];

(iv) Likewise, a default notice should be sent for the second defaulted repayment. If one is not, and the borrower rectifies the first defaulted repayment but not the second, then the lender once again cannot enforce the SACC until a fresh default notice is issued and the 30 day time period waited;

(v) We must make contact with the borrower before attempting any further direct debits on their account. The Credit Regulations require that after two dishonoured attempts, further direct debit attempts cannot be made unless the borrower has been contacted to inform them the requests have been unsuccessful (or reasonable attempts have been made to get in contact); and

(vi) Two direct debit dishonour charges are incurred via our direct debit processing company.

Practicality dictates that actions (i) to (v) occur as soon as possible, since multiple time frames become involved:

- The direct debit default notices have a strict 14 day requirement;
- The default notices have a 30 day rectification period. The longer a lender waits to send a default notice, the longer they must wait before commencing enforcement proceedings; and

[13] Section 87 of the *Code,* Form 11A.

[14] Subsection 87(2) of the *Code*.

[15] Subsection 88(3) of the *Code*.

[16] Schedule 1, Item 86 of *Electronic Transactions Regulation 2000 (Cth)* exempts the ability to send a default notice electronically.

[17] Sections 184 and 208 of the *Code*; sections 6 and 110 of the *National Consumer Credit Protection Regulations 2010 (Cth).*

- If contact is not made or reasonably attempted, within 13 days of the first direct debit dishonour (accepting that the second also dishonoured) then a third (and subsequent) repayment draw attempt cannot be made. This obviously stalls the SACC repayment schedule completely.

Considering the example 14 days raised in option 4, we would be required to absorb the cost of preparing and sending two default notices (including two direct debit default notices) by mail, two direct debit dishonour fees from our service provider and any costs in making/attempting contact with the borrower concerning their defaults. All of which, we point out, is work that would be incurred through no fault of our own.

A portion of these fees are also 'hard', external expenses; including the fees from our direct debit service provider, the cost of materials and postage for the letters, and any telephone call charges.

These considerations compound when considering that lenders already suffer from the reduced cash flow caused by defaulted payments, for which there is no compensation save the limited amount which may be afforded in monthly fees from the extended term of the contract (which is capped in any case, and not obtained until the end of the contract if at all).

3.2 - Option 5: Introducing a cap on how quickly fees may be charged

Several of the comments in this option show a lack of understanding as to the requirements and practical realities of SACC lending, as we refer to our comments in 3.1 accordingly:

(a) "*Option 5 may encourage SACC providers to take steps which are more effective in having a default remedied".* Effective or otherwise, this comment ignores the regulatory requirements that SACC lenders must complete, and the strict time frames involved;

(b) *"The intent... would be to set it at a level that is equal to the reasonable costs of recovery."* This causes concern for three reasons:

(i) Some fees, such as our direct debit service provider's default fee, are not about recovery but represent the cost of the default activity occurring. Expressing the costs to be about 'recovery' ignores this fact;

(ii) We see no justification or standing to determine what is a 'reasonable cost' of recovery, fearing this may end up the same way as the current caps on establishment and monthly fees; and

(iii) The very nature of the actions taken and the time frames involved means that several things are done immediately following an event of default. The apportioned nature of option 5 fails to take into account this sudden, necessary 'burst' of activity;

(c) *"Automated technology has significantly reduced the cost.."* This comment presupposes that all SACC lenders have access to automation, and that it is suitable. It also doesn't recognise that the access and upkeep of such technology is not free. But, most of all, it dismisses the obligations placed on the SACC lender at law to ensure its compliance with its obligations

under the *Credit Act*. Automation without oversight is derogated extensively by the regulator; and

(d) *"...taking remedial action (for example, by automatically sending a text)."* This comment ignores the legal reality of the compliance requirements on a SACC lender. A text message is insufficient, for example, to comply with the requirements of sending a Form 11A , and cannot be used as a statutory default notice because it couldn't possibly contain the required information in subsection 88(3) of the *Code* and Form 12A. It would also fail the requirement that default notices cannot be sent electronically. Further, sending a text message constitutes a form of contact under the ASIC/ACCC Debt Collection Guidelines - which 'gives guidance' as to the limited number of times of contact a lender should have with a borrower. When other forms of contact either must take place or allow for a better degree of communication between the parties, sending a text message can 'eat away' at the already restricted contact chances afforded by the Guidelines[18].

Placing a cap on how quickly fees could be charged would force lenders to either:

- Only do what is required by law, in an effort to decrease unrecoverable costs - which is usually less effective and doesn't constitute an effective means of communication from a public point of view; or

- Do what is necessary and what else may be effective, and wear the costs of doing so as an unrecoverable expense.

Since there is already an absolute restriction placed on the charging of default fees, we do not see that further restriction can be implemented either fairly or equitably. We point out, again, that actions taken in these circumstances are when a borrower defaults on a contractual obligation – something the lender cannot control.

3.3 Option 6: Capping default fees as a percentage of the amount outstanding

This option correctly identifies that many of the costs incurred upon default are fixed, having no correlation to either the amount outstanding or the amount of the default. Restricting allowable default fees to a percentage of the amount outstanding is not a sensible option for consideration on this basis alone.

The only way such a proposal could attain a fair compensation for the lender's costs would be to allow a percentage with gave an overall approximation of the cost across all defaults. The problem with this approach lies in the 'extremes': the percentage allowable on a tiny outstanding amount would need to be balanced against the amount achievable on a higher outstanding amount. Otherwise, the diminishing nature of the allowed charge will ensure that lenders lose money when defaults occur. This would be patently unfair to the lender.

Of course, the balancing position (wherein the lender may receive a greater amount that the underlying cost at the beginning of the SACC), would quickly be decried as 'unfair to the consumer'.

[18] We accept that the Guidelines do not have legislative backing. However, they are the benchmark against which the regulator measures legislative compliance and failure to comply is done at the lender's risk.

A further reason why this isn't a suitable option lies in the possibility, if implemented, that borrowers may 'get away' with not paying the final part of their SACCs. As the balance drops and the corresponding ability to charge on default events, the cost of pursuing the debt will become increasingly uneconomical when measured against the balance. This may also prompt lenders to aggressively pursue defaults as soon as possible.

Lastly, if the preceding reasoning is not sufficiently effective then consider the costs a lender bears if a loan is taken to external dispute resolution. We wager that borrowers have more control over committing an act of default than lenders do over whether a complaint is made to the EDR scheme. We see no proposal that the ombudsman charges for dispute resolution be calculated on a 'reducing balance'. Their work is the same regardless of the amount outstanding – just the same as a lender's.

If the government is unwilling to expect an EDR scheme to reduce their fees because of the dollar amount at issue, we see no credible reason why lenders should be expected to do the same with default fees; particularly as the EDR fees commonly dwarf the total gross profit achievable on a SACC in total (per our comments above at pages 7 to 8).

3.4 - Answers to specific questions

3.4.1 With our SACCs, the following events can occur when a consumer defaults. All charges are passed on at cost, and the figures are current charges. Fees which do not have an 'internal' component (representing pure hard costs) are noted as 'external costs':

(a) Default notice (incorporating Forms 11A and 12A): $20.00;

(b) Telephone call: $5.00;

(c) Direct debit dishonour fee: $16.50 (external cost);

(d) Having a field agent visit the borrower: unascertainable, but at least $77.00 per visit (external cost);

(e) Referring a debt to an external debt collection agency: 24.75% of the amount collected (external cost); and

(f) Filing an originating claim with the small claims tribunal (QCAT, by electronic lodgement): between $38.89 and $123.79 (external cost).

Items (a) and (b) also obviously incorporate some degree of hard cost (wages, utilities, stationery, postage, telephone call charges and the like).

3.4.2 Our repayment cycles are weekly and fortnightly, with fortnightly cycles accounting for approximately 60% of SACCs.

In our opinion, there is no appropriate default fee window for the reasons given in 3.1 above. An act of default is an act of default. It is beyond the control of the lender, and penalising them by requiring they perform regulated actions whilst denying them the opportunity to be compensated for their loss would be a draconian development.

3.4.3 For the reasons given in 3.2 and 3.3, neither option is either suitable or fair to lenders. All our default fees are charged at their cost to us - including those with an internal component, calculated as a representation of the cost to us of performing the work necessary.

4. - **<u>Options 7 and 8: Early repayment and repayment amounts</u>**

4.1 - **Option 7: Specifying information regarding early repayment**

This option appears to have a wide ambit, as shown by the three 'sub-option' examples given:

(a) Example 1 and 2 have the same basic effect of making the 4% monthly fee a reducing figure. As stated, this will render returns on SACCs economically unviable. We further note the example doesn't state that the percentage could be calculated on the outstanding balance, but merely the declining balance. It is inequitable to subject a lender to this; and

(b) Example 3 aligns with our method of charging monthly fees, and reflects what we believe to be the intent of the legislation. We have no objection to this method being used.

4.2 - **Option 8: Requiring equal repayments over the life of the loan**

We do not use the type of repayment structuring contemplated by this option, and have equal repayments over the term of the SACC. While we consider such structuring to be a novel response to the problems caused by the SACC regime, we have no objection to requiring repayments to be equal across the term.

We do point out, however, that a clear exception should be made for the last repayment which may necessarily be smaller than the usual repayment.

4.3 - **Answers to specific questions**

4.3.1 No. We consider the overall remuneration for a SACC (at 20% establishment and 4% monthly, maximum) to be insufficient overall, that allowable establishment fees are insufficient to cover costs in at least the majority of instances, and monthly fees do not provide a sufficient return for the effort and risk of the lender. Any measure to force lenders to cut already insufficient returns is completely untenable.

4.3.2 As stated in 4.2, our SACCs have equal repayments across the term. A lender may have legitimate reasons for requiring a larger repayment at various times, however, such as:

(i) Requiring a larger initial repayment so that the borrower repays the establishment fee portion quickly – so they can recoup a degree of their expenses;

(ii) Having a smaller initial payment so that they can get under the 20% protected earnings cap for social security recipients, before raising it to the normal repayment rate once an existing loan is repaid; or

(iii) To cater to a borrower's specific needs from their SACC due to their particular financial situation.

4.3.3 We are unaware of the extent of this practice. As stated, we do not engage in such a practise.