Promoting Responsible Consumer Lending

Response to the

Interim Report on the Review of the small amount credit contract laws

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By email: consumercredit@treasury.gov.au

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National Credit Providers Association

submission to the
Review of the small amount credit contract laws
Interim Report December 2015

The National Credit Providers Association (NCPA) would like to thank the Review Panel for this opportunity to provide more evidence as recently requested by the Panel and to provide our response to the Interim Report.

Recently[1], the NCPA brought to the Panel's attention our serious concerns about some of the underlying data quoted as the basis for the proposed reform options in the Interim Report. Key concerns from that correspondence are included in this submission for completeness and benefit of other readers. Subsequent to sending that letter, we have identified further significant misquotes and references to non-SACC data. That new information is also contained in the body of this response.

At the start of this review process, it was stated by The Hon Josh Frydenberg MP, Assistant Treasurer, in his media release of the 'Review of the Small Amount Credit Contract Laws'[2] that; "… *establishment of the review fulfils a statutory requirement under the Credit Act, to examine and report on the effectiveness of the law relating to SACCs*" (emphasis added). The Terms of Reference supplied with that media release went on to clearly state: "*The review is required to examine and report on the effectiveness of the law relating to small amount credit contracts (SACCs), in accordance with section 335A of the National Consumer Credit Protection Act 2009 (the Credit Act).* (emphasis added)".

It is clear that it was intended that this review was to be concerned with the effectiveness (or otherwise) of the current SACC laws. Although a comparison of pre-SACC issues may be a worthy exercise, that process is not explored in the Interim Report and no comparison data is provided, nor, so far as we can ascertain, was it made available to the Review Panel for comparison purposes. Of key concern to the NCPA is that some pre-SACC data is used in several key quotes and expressed observations and/or opinions is incorrectly presented as if this data relates to the current SACC regime, which it does not.

Furthermore, the report lacks current data to support such 'observations' and the resulting proposed reform options. Without the support of current and relevant SACC data, the report uses loose and unhelpful language such as 'it appears', 'it seems', etc., as inappropriate surrogates for fact based analysis.

NCPA takes the view that in relation to this already highly regulated product, the industry is long past reform options which are based on the wandering generalities detailed earlier. There is either a qualitative market failure that warrants change or there is not. We should not have change for the sake of change. The NCPA acknowledges that some very minor

[1] Email from NCPA to SACC Review Panel via the Secretariat dated 6th January 2016
[2] http://jaf.ministers.treasury.gov.au/media-release/037-2015/

tweaking may be needed, but nothing to the extent of the Review Panel's proposed reform options.

With the above concerns raised with the Review Panel, the NCPA asked the Panel to supply *any* current SACC quantitative data that demonstrates a necessity for legislative change. The Panel formally declined to do so. This, in our opinion, confirms our view that there is no evidence that is either current and/or relevant to this review to indicate that the legislation warrants the majority of the changes espoused in the Interim Report.

It appears that the only current data relevant to the effect of the 2013 Enhancements Act is that provided by NCPA (as the peak national industry body) contained in the CoreData research[3]. All other statistical information on which the Interim Report relies appears to be:

1. limited in its application (e.g., by only applying to one lender);
2. aged and therefore not relevant to current requirements; or
3. not specifically related to SACC loans.

The Reality:

Whilst no adverse outcome for a consumer is ever intended, the NCPA and its Members are the first to acknowledge that this can sometimes occur. It is a fact that our Members employ staff (who can and do make mistakes) and use computer assessment models which also are not infallible even though many of these models have hundreds of 'decision tree points' to assist loan underwriting decisions. It should also be noted that ASIC has made it clear that it does not believe there is any computer-based assessment model which complies with responsible lending obligations and therefore requires human involvement in the granting of every loan.

As an industry, we could spend millions of dollars attempting to reduce a small error rate (e.g., introduce bright line tests etc.) and still not succeed. For our Members, it has always been about how quickly a mistake and resultant negative outcome on the consumer can be resolved in favour of the consumer. We firmly believe that this is where meaningful reform should occur, by implementing processes to quickly help consumers when something goes wrong. This is the original intent of the NCCP by creating IDR.

There are two parties to a consumer credit contract. The greatest reform for consumer protection will only occur when the political 'hot potato' of responsible consumer borrowing is implemented. This shift in focus would produce a brave and meaningful reform compared to a continual negative focus on the minute failings of licensed lenders who strive to comply with responsible lending obligations and service consumers' demand for credit.

[3] http://smallloansbigneed.com.au/info-centre/research-findings/

Key concern: Relevance of data quoted as the basis of observations leading to many of the proposed reform options:

DFA Report: Specifically, reference is made to the Digital Finance Analysis (DFA) "survey results" about 6 times. As the Panel is aware, the NCPA went to extreme lengths (and considerable expense) to find, assess, and engage *CoreData;* a data collection and survey administration and reporting firm whose reputation relies (or dies) on absolute compliance with Australian and international data gathering and reporting standards.

When stakeholder submissions became available referencing DFA, alarm bells immediately rang due to significant variations in data results between CoreData and DFA. The NCPA tracked down and spoke to the author of the DFA report. In summary, Martin North from *Digital Finance Analytics* has confirmed these numbers are a 'best guestimate' based on the methodology of *data extracted from a household omnibus survey of a total of 26,000 households over more than 10 years, THEN normalised to the ABS census data at a postcode level, THEN subjected it to segmented analysis by key household characteristics.* For clarity, this was an omnibus survey where data on a wide variety of subjects is collected during the same interview. This omnibus style of survey is also called piggyback surveying as the survey asks 'households' many questions on multiple topics to share the cost of the research. It was not a survey of 26,000 households on a particular topic, but was a collection of information from 26,000 households over a period of 10 years, some of which were asked for information about lending. The data obtained was then changed to conform to ABS census data by postcode.

Also of importance, is that DFA advised that the data they used was not all obtained through their own devices, but was purchased or acquired from a third party supplier – leading to further unknown unknowns about the collection of that data.

The data was based on polling the age of the primary householder which was not necessarily the age of borrower as referenced.

This omnibus research is done primarily by phone to consumers **who have to recall details about various loans they had in the last 12 months**. That nebulous information was then reverse engineered (adding another layer of guestimation) as described above against **HOUSEHOLD** data (i.e., **NOT CONSUMER or even BORROWER data).** Furthermore, 2012 Household ABS data was gathered **prior to commencement of SACC legislation (July 2013)** and therefore is not appropriate to be used as a data set for this legislative review.

The DFA report cannot be relied upon for any SACC information, trends or otherwise and should be removed from the information being used to inform the legislative review.

The Coredata survey was a direct analysis of information directly from the lenders' software systems, with none of the distorting methodology used by DFA.

Furthermore, on page 10 of the Interim Report, the Panel incorrectly references the DFA report again in regard to SACCs.

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

SACC loans, with all their protections and caps, did not exist before 1st March 2013, yet the report inappropriately included this entry from 2010 as data about SACC! There were no SACCs and related protections before 1 March 2013.

The scope of this current review is a review "***of the effectiveness of the SACC laws***". It is not a review of payday loans, or products in the market place prior to SACC and any issue those products may have had.

Requested Action: The DFA report contains information outside the TOR that should be struck from this Interim Report as the data provided is inappropriate and irrelevant to the Review and misleads readers.

ASIC Report 426: The NCPA's members are dumbfounded at the continued use of this flawed ASIC report which is NOT relevant in any way to lenders providing SACCs in 2015. It was a survey that was done 7 weeks after the legislation commenced in 2013**. The survey was done at a time when the legislation, and credit providers and consumers reactions to it were not fully formed. ASIC and Treasury could not decide how various RLOs should operate and Treasury could not give an authorative answer as to how various sections of SACC laws were to operate.** ASIC criticised lenders in that report for failing to comply with future requirements that were not even in existence. The statistics in the report were misleading at a minimum (Refer to our submission on the original consultation paper for further information about the inadequacies and inappropriateness of ASIC Report 426 for the purposes of this Review.)

It is inconceivable to industry that this report is being used as the basis for any observations resulting in proposed reform options. For instance, page 7 of the Interim Report *found* " *… compliance with the responsible lending obligations are low …* " That statement was correct in August 2013 only 7 weeks after the laws commenced. However, as stated previously, even ASIC, it seems, did not fully understand the requirements back then, let alone the legal advisors to the entire credit sector who base their advice on not yet available guidance from ASIC. There had been no allowance for the bedding-down of this new legislation which introduced broad and sweeping significant change into the operation of the small loan industry. In this regard, it is significant to note that major changes were still being made (by Class Order 13-818) very late on Friday, 28 June 2013 when the capping regime commenced on Monday, 1 July 2013. Most lenders did not know about these changes until after the new regime commenced.

We are aware that in September 2015, ASIC sent a request to a number of lender for information "to assist with gathering information on small amount loans for the period 1 July 2014 to 30 June 2015"**.** ASIC noted that it had not chosen to use its information gathering powers, but requested the information on a voluntary basis. It requested responses by 21 September 2015.

ASIC, like the rest of us, had been aware that there would be a review in 2015 from the time the Enhancements Act was passed in early 2013. It appears that no attempt by ASIC was made to gather further information until after the review Panel had been appointed (7 August 2015) and at about the time the initial discussion paper was issued (17 September 2015).

Where is the information ASIC obtained? Why does not form part of their submission and this Interim Report?

If it is the case that ASIC does not possess any current data, then simply, they have no current data to submit to this Review on these matters.

Facts from current and relevant data - CoreData's 2015 Consumer survey of loans under $5,000 & CIO's 2015 Annual Report on Operations

Before addressing the specific questions asked by the Panel, the NCPA provides the following points and high level observations. These observations are supported by current, relevant factual data on SACCs from the CoreData 2015 survey of 2.4 million contracts for the period 1 July 2013 to 30 June 2015, together with actual data as contained in the CIO 2015 Annual Report on Operations for the 2014/15 financial year. The combination of these facts then form the basis of our comments on the proposed reform options.

Before discussing these facts, the NCPA wishes to disclose a caveat to the information presented in the CoreData report so as not to make errors in deductions from the report findings. This caveat concerns the data gathering methodology whereby responses were sought concerning various loan types under $5,000 which obviously includes information concerning MACCs as well as SACCs. When discussing the CoreData results, the NCPA will only refer to SACC results, unless specified otherwise.

Fact 1. Over seventy percent (72.5%[4]) of consumers who take out a SACC loan still walk through the door of a retail outlet. Given that consumers prefer to take out a loan on a face-to-face basis, this means that there is a significant outlay by the lender to keep a physical office operating and staffed, irrespective of whether they also offer loans online. Although some lenders assert that they can operate online at much lower costs, with most of the SACC consumers still walking through a physical door to access a loan, any legislative changes must still support the retail cost base. Anecdotally, our Members report that maintaining a high street office is far more expensive than maintaining an online presence where advantage can be taken of lower rents in more industrial areas and/or the use of call-centres.

[4] NCPA Submission to SACC Review, Page III – Facts Discovered by 2015 [Coredata] Survey. See also the Consumer Credit Legislation Amendment (Enhancements) Bill 2012 Revised Explanatory Memorandum page 241 where it was noted that in 2006 research showed that 50.1% of applicants received social security payments. The Revised Explanatory Memorandum is available at http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r4682

This evidence is strongly indicating that the demand for SACCs is predicated by the demand through retail outlets, as such the legislation must ensure that this business model remains viable in the future.

<u>Fact 2.</u> More employed consumers use SACCs than Government Benefit recipients and the gap shows a widening trend[5]. It is estimated that around 67.5% of all SACC borrowers will be consumers in employment by the end of 2016 based on a two-year linear trend. This trend means that fewer Government Benefit recipients compared to employed consumers will seek SACC loans.

This was the intention of the SACC legislation and this strong linear trend demonstrates that the current legislation is working.

<u>Fact 3.</u> When online-only lenders were examined, the percentage of employed consumers compared to consumers on government benefits was considerably higher than in Fact 2. For online-only lenders approximately 5 out of 6 consumers (83%) were employed[6].

This information, together with Fact 2, clearly demonstrates that SACC loans are being used less by consumers receiving Government benefits and provides very strong evidence that the SACC legislation is working as intended.

<u>Fact 4.</u> CoreData results show that 99.95% of consumers never have a problem with the product. Contrary to vociferous assertions by consumer advocates that they see 'many' people with problems with 'payday loans', their highly sensationalised media articles can only ever be drawn from the remaining .05% **(5 in every 10,000)** consumers who *<u>may</u>* have had a problem with the product. It is very significant that not one consumer advocate submission provided any statistical data about the actual number of SACC related issues.

This is significantly strong evidence that the legislation is working as intended to protect SACC users and that there are extremely low or very few complaints about SACCs.

<u>Fact 5.</u> CIO data supports the very low statistics regarding complaints. This current and relevant evidence is available directly from CIO's latest annual report to support the fact

[5] CoreData p10 Graph "Status of Customers", Consumer Credit Industry Report, October 2015.

[6] The CoreData trend for usage of SACC loans by employed compared to on-benefits consumers as analysed by business model shows a trend of access-usage from almost 90% (8 out of 9) in the first quarter being employed consumers compared to the last quarter where 83.3% (5 out of 6) of consumers were employed. This trend could be influenced by many factors such as: lenders being extremely cautious as they become used to working online with the new legislation being in place and low income earners now having greater access to internet facilities in which to access this model of lending. CoreData p10 Graph "Customers: employed to on benefits ratio by business model", Consumer Credit Industry Report, October 2015.

that SACCs generate an all-time low number of issues relevant to both a percentage of transaction numbers in the marketplace and as an actual count. This outcome is despite certain consumer advocate groups actively encouraging people to lodge complaints directly with CIO before first seeking redress of a problem through IDR as legislation dictates. Furthermore, this outcome is despite mandatory conspicuous reference to EDR in all NCCP required documents.

The Interim Report seriously misquotes and misinterprets the information from CIO's submission in the initial review paper. The Interim Report on page 8 states:

> *Complaints about responsible lending and unjustness make up 18.4 per cent of all complaints about SACC lenders received by the CIO. This is more than three times the number of responsible lending complaints received about providers in other sectors.*

Both of these sentences are incorrect and are not reflective of the topic they are associated with in the Interim Report:

Interim Report Statements on page 8	What the source data actually stated
"Complaints about responsible lending and unjustness make up 18.4 per cent of all complaints about SACC lenders received by the CIO"	An examination of the CIO 2014/15 Annual report on Operations, on page 44 finds the correct information. The 18.4% statistic and quote is related to the **combined statistics for both Small and Medium Amount contracts, i.e., SACCs *and* MACCs**. That is, **CIO did not supply any data that could be specifically isolated to SACC contracts.**
"This is more than three times the number of responsible lending complaints received about providers in other sectors."	*"This is at* ***least three times the average level*** *for this category of complaint for all other classes of FSP members of CIO"*[7] (emphasis added). This is a most significant misquote from CIO's submission in the report. The "level" being the percentage – not the number of complaints.

[7] Submission by CIO to The Review of the Small Amount Credit Contract Laws, p5

Percentages without the underlying base number do not provide any meaningful data, i.e., 18.4% of 100 cannot be compared to 1% of a 1,000,000 (10,000) as a quantitative number of issues. We have extracted from CIO's 2015 Annual Report on Operations, the actual number of RLO issues.

These are the facts from CIO's 2015 Annual Report on Operations.

There were, in fact, only 283 complaints received by CIO[8] in 2014/15 for all issues that related **to both SACC *and* MACC** products[9]. Of the received complaints, 28.6% or 81 were not substantiated.[10] Of the remaining 202 complaints, 18.4% or only **37** cases related to "Inappropriate finance, including responsible lending – for both SACC *and* MACC loans"[11].

The CoreData Report recorded that for the same time period, 1,274,942 SACC contracts and 19,170 MACC contracts were provided. CoreData estimated these values to represent 95% of the total market, giving an estimated number of total-market SACCs for 2014/15 at 1,342,044 contracts and 20,178 total-market MACCs or a total market of 1,362,222 for both SACC and MACC contracts.

Using CIO and CoreData information with the same base line of SACC & MACC data from the 2014/15 year; there were 37 complaints that related to RLOs against a minimum of 1,362,333 SACC and MACC contracts, resulting in a complaint rate of 0.00027% or approximately 2.7 RLO complaints for every 100,000 SACC and MACC's entered into.

Therefore, the complaints for SACCs is even less than this incredible low rate.

It must be noted that the regulator, ASIC, and some other observers think the market is much larger thus reducing even further the size of RLO obligation issues as a percentage of contracts provided.

A further unintended distortion of this incredibly low number of RLO complaints was not picked up by CIO when they stated in their submission "*This is at **least three times the average level** for this category of complaint for all other classes of FSP"[12].* Statistically, this implies RLO's for all classes of FSP are the same when that is not correct. SACC providers have significantly more RLO's to comply with and hence more possible areas for complaints. CIO was not comparing 'apples with apples'. Appendix 1 graphically demonstrates the differing RLO requirements of FSPs who provide credit.

[8] These numbers only relate to those SACC lenders who use CIO as their EDR scheme.
[9] CIO 2015 Annual report on Operations, p38 available at http://www.cio.org.au/publications/annual-report-on-operations/annual-report-on-operations-2015/
[10] Ibid, p51
[11] Ibid, p44
[12] Submission by CIO to The Review of the Small Amount Credit Contract Laws, p5

The only conclusion that can be drawn from the above examination of facts is that no data has been provided, based on the CIO report, that even hints at a market failure or lack of compliance with RLOs that warrants change.

Examination of the evidence from these two data sources forms extremely current and relevant evidence that the legislation is working well in regard to RLO's.

Fact 6. "Repeat borrowing" is exactly what the legislation says *must occur* to protect consumers from accessing "excess" funds in one loan. Lenders don't engage in repeat borrowing but consumers do; because the law forces them to do so.

Extremely obvious and industry-wide compelling data that debunks the assertion that repeat borrowing is an issue (supplied in our main submission but repeated here) is found in an examination of CoreData's report. Drawn from data provided for a two year period from 1st July 2013 – 30th June 2015, CoreData's information shows that 2.4M SACCs were taken out by 1.788M consumers or, on average, each consumer had only 1.3 SACCs over two years.

This does not appear to represent a statistic showing a repeat-borrowing problem.

No policymakers will be able to legislate to restrict, dampen, or control consumer demand – repeat borrowing. If consumers cannot access safe credit from an ASIC licensed lender, they will source it elsewhere. Acting outside legislation in this manner will leave consumers totally unprotected by any legislation. The reason consumers appear to repeat borrow is because the lender, under RLO, can only provide the funds required at the time of any loan request, i.e., the purpose and objective of the loan.

Consumers return when a future need arises. This situation is to be expected as a consumer's future need for credit does not end just because they have had one or more loans in any given time period.

Furthermore, consumer advocates often characterised repeat borrowing by concurrent borrowing. CoreData results show very clearly that less than 7.8%[13] of new contracts were entered into with consumers who had an existing contract.

These facts provide strong current and relevant evidence that responsible lending obligations under SACC legislation are working to restrict repeat and/or concurrent borrowing as intended to protect consumers.

[13] CoreData p17 "Multiple-contract instances as % of all new contracts", Consumer Credit Industry Report, October 2015.

Fact 7. Factual consumer outcomes indicate that repeat borrowing is not a problem. That is the NCPA looked for evidence that would occur if repeat borrowing was a problem in the market place.

An examination of data from several directions shows that continual claims that SACC repeat borrowing leads to increased financial hardship is not supported by any evidence. Page 26 of CoreData's report presents a graph entitled "Options offered to customers experiencing hardship" which shows that lenders work with an array of options for consumers when they request hardship consideration as now required under SACC legislation. Another graph on page 26 entitled "Hardship cases as % of active contracts" shows the number of consumers seeking formal hardship consideration as a percentage of active loans is infinitesimally small at about .005%. On the same graph, the number of informal approaches for hardship consideration has dropped from a 'high' of 4.5% in 2014 to a low of 2.5% in the June quarter of 2015.

A graph on page 24 entitled "Actions against bad debt as % of active contracts" shows a dramatic drop in recovery action for bad debt to a percentage of .0005% for both types of action. If repeated borrowing, according to some advocates, is creating such a tremendous financial imposition on consumers, then these figures would be increasing and not dramatically decreasing as they are.

This is current and relevant proof that the legislation's requirement for very restrictive responsible lending obligations coupled with a greater propensity for lenders to accept all or any hardship requests (verbal or formal) to reduce costs is working as intended to protect consumers.

Fact 8. No evidence of Debt Spiral was provided in regard to SACCs.

On page p12 of the Interim Report, the Panel incorrectly, in our view, states: *"Several submissions recognised that the repeat use of SACCs can lead to unmanageable debt and debt spirals. This view is also supported by academic literature".*

The Interim Report cites footnote references 38 and 39 to support this statement. A close examination of these references show that they were incorrectly cited and not related to issues caused by SACC's since 1st July 2013.

The first reference (Reference 38) from a CALC report is actually a re-quote of reference 39. The problem with this citation, simply stated, is that CALC did NOT provide any information or data to support claims of repeated SACC borrowing leading to debt spiral.

Instead CALC requoted *"Ali et. al., 'The politics of payday lending regulation in Australia', Monash University Law Review, 2013, p.15."* which was footnote reference 39[14].

A close examination of footnote 39, ('*The politics of payday lending regulation in Australia', Monash University Law Review, 2013, p.15*.") finds that **data relating to the issue of "*unmanageable debt and debt Spirals"* was in fact to do with loans in 2012 or earlier, <u>and nothing to do with SACCs from the 1st July 2013</u>.** In other words, this source provides information which is outside the TOR of this current review.

It is not possible for any legislation to provide a panacea for each of the millions of permutations of life's situations that a consumer may find themselves in. Likewise it is not possible to second-guess all of the situations in which a consumer may find the need for finance at any point in time. The imposition of, for example, bright line tests, will mean financial exclusion leading to consumers accessing finance from unlicensed sources.

The following section addresses specific requests by the Panel.

[14] A copy of this paper can be accessed at http://law.unimelb.edu.au/__data/assets/pdf_file/0003/1709508/26-201421.pdf.

Information on trends in the SACC and leasing industries including consumer characteristics	
Option – N/A	
Further Information Requested	**NCPA response**
Information on trends in the SACC and leasing industries including consumer characteristics	NCPA holds no information on the leasing industry. NCPA only holds and publishes information on the SACC industry which includes some statistics particularly related to consumers. A summary of this information can be found on the Small Loans Big Need website on the Research Findings page. Further key information can be found in our initial submission but particular items are discussed below for the purpose of answering the Panel's request for more evidence on specific issues. The information presented below was collected, consolidated, and presented by CoreData in their report Consumer Credit Industry Report October 2015. The data was designed to capture trends over the two years from inception of the SACC legislation and commensurate with the TOR for the Review. Consequently questions were broken down into 8 quarters commencing 1st July 2013 and running through to 30th June 2015. This breakdown into quarters enabled trend information to be analysed since the introduction of SACCs. Given that the legislative review is to be a review of the effectiveness or otherwise of the current SACC laws, this timeframe was specifically chosen to provide factual data based on the purpose and scope of the review. This makes the CoreData results extremely current and relevant to the review process at hand. On release of the Interim Report, the NCPA sought clarification from the Panel on what additional sets of data were being requested. The Panel responded, *"any available data on trends that providers can identify with evidence such as increases in repeat borrowing over time or decreases in amounts borrowed or the age of borrowers changing or the income of borrowers changing over time."* In its response, the Panel did not define the time frame required for such trends, but given the focus of the review is the effectiveness or otherwise of legislative law from 1 July 2013, then this is the timeframe about which NCPA provides the following quantitative data. The NCPA provides supporting data concerning these 4 trends about which the Panel has requested further evidence. Each of these will be discussed below. *Trend 1: Information about repeat borrowing over time* Based on the analysis of 2.4 million contracts capturing trends over two years (8 quarters) CoreData analysis indicates that **there is a very low**

Information on trends in the SACC and leasing industries including consumer characteristics	
Option – N/A	
	incidence of repeat borrowing[15]. On page 17, a graph shows slightly fluctuating values on the number of borrowers who have an existing loan at the time of taking out a new loan. However, in the last quarter only 7.8% of consumers had an existing loan. This trend information is more fully discussed in Fact 6 above. Such a low percentage is strong current and relevant evidence that repeat borrowing is not a problem. Furthermore, as discussed fully in Fact 7 above, if repeat borrowing was such a continuing problem causing hardship to consumers, it would be reasonable to expect that the percentage of hardship cases for the number of active loans would be either increasing. However, the top CoreData graph on page 26 shows the opposite, i.e., that percentage of hardship cases compared to active loans has now **decreased to infinitesimally small** at about .005% (less than 5 in 10,000 loans). **These CoreData results are current and relevant evidence that there is no trend towards increased repeat borrowing leading to greater consumer financial hardship and no market failure indicative of requiring harsher legislation.** *Trend 2: Information about amounts borrowed over time* The Coredata survey showed that the average loan amount reduced from $510 in the 2013/14 year to $502 in the 2014/15 year. **The average amount being borrowed does not appear to hold any significant trend information.** It is significant to note however that in ASIC's submission to the review [16] (whilst not naming the ADIs) ASIC says that its research found that there were 15 ADIs prepared to provide loans of less than $2,000 to consumers. The average loan amount, according to the submission, appears to be slightly less than $1,400. It seems these unnamed ADIs do not provide the type of loans required by consumers in this area, notwithstanding the fact ADIs are not bound by the same RLOs. *Trend 3: Information on age of borrowers changing over time* The summary presented by CoreData on page 9 referring to the age of consumers is evidence that the average age of SACC of male and female consumers remains stable over time. "Typical" customer is in their mid-30s. The typical customer of a consumer credit provider is in their mid-30's. In Q2 2015, the average age of all male customers who entered into a contract was 36, while the average age of all female customers who entered into a contract was 35. These have remained largely unchanged since Q3 2013. Customers of online-

[15] CoreData p17 "Multiple-contract credit advanced as % of total credit advanced", Consumer Credit Industry Report, October 2015.
[16] Submission by ASIC, dated October 2015, page 12, paragraph 52

Information on trends in the SACC and leasing industries including consumer characteristics	
Option – N/A	
	only lenders were on average, slightly younger than customers of other lenders."[17] **The age of both male and female borrowers remain stable at 37 and 36 years respectively.** *Trend 4: Information on income of borrowers changing over time.* While NCPA has no direct evidence concerning the trend in actual income of borrowers over time, there is evidence that can serve as a proxy for this as noted in Facts 2 and 3 above. Fact 2 shows evidence that more employed compared to on-benefits consumers are using SACC products and that this is a widening trend. Fact 3 shows even stronger evidence in the on-line only lending market where approximately 5 out of 6 consumers (83%) were employed. **These two facts presented could be an indicator that the income of SACC borrower's could be increasing, as more employed consumers than on-benefits consumers use SACCs.**

Proposed Reform Option 1	
Option 1 Reduce the establishment fee for subsequent loans for a returning customer from 20 per cent to 10 per cent.	
Further Information Requested	**NCPA response**
None requested but further evidence has been supplied.	Option 1 appears to be framed in the context that a decision has already been made to incorporate Option 1 into legislative changes and the only following option is then as to whether Option 2 or Option 3 should be added to Option 1. As shown on Fact 1 above, 72.5% of SACC consumer prefer to walk in to a SACC provider's office rather than access funds on-line. This proposed option has enormous ramifications for the continued ability for consumers to access finance in the way they prefer which is through a retail outlet. Decreasing financial viability for the SACC industry from the imposition of further compliance costs from such an option will carry a huge negative financial impact on lenders especially for those that supply services through a retail outlet. Part of the existing 20% charge MUST cover the cost of all rejected loan applications. The Interim Report

[17] From Graphs on page 9 which presents information of Customer Profile, Consumer Credit Industry Report, October 2015.

Proposed Reform Option 1	
Option 1 Reduce the establishment fee for subsequent loans for a returning customer from 20 per cent to 10 per cent.	
	appears not to have considered this fact. At a whole-of-business level, the fee for a successful loan must cover all non-loan work as well. Current relevant evidence from CoreData on pages 14 and 15 shows the **number of loan applications rejected has now increased on average to 4 out of 10 applications.** Some lenders, particularly those online, reject in excess of 90% of applications[18]. Having to process this number of applications (as lenders carry out their considerably onerous responsible lending obligations), which do not lead to any income producing activity, is a huge financial burden to bear. All businesses, not just SACC lending, must factor in the cost of dealing with all potential customers that do not progress to an income generating 'sale'. This is a recognised factor of doing business and is not restricted to SACC lenders. Insisting on any legislative changes without recognising this factor does not give due consideration, as required by the Review, to create a balance between providing consumer protection while still maintaining industry viability. The Panel has noted that "subsequent loans are more profitable than the first loan".[19] It also noted that "upfront administrative costs are significantly lower" for subsequent loans. [20] No data from any submission was provided to support these statements or the statement that there is a "*misalignment between the maximum establishment fees and the actual costs incurred"*. RLOs do not differentiate between the necessary steps in assessment of a first, second, or subsequent loan. Therefore, apart from possibly obtaining a copy of a driver licence or other identifying documents, the administrative costs for a second loan are the same as those for a first loan. Furthermore, it appears that the inclusion of this option is an attempt to solve a problem that doesn't exist. The perceived problem appears to be that consumers need further protection in the form of reduced costs to curtail perceived hardship problems associated with repeat borrowing. Even though the NCPA requested evidence from the Panel to support these perceived problems, no current data was supplied to show any market failure had occurred in regard to repeat borrowing of SACC's since 1 July 2013. On the other hand, NCPA has now shown (in Facts 6 and 7) that CoreData results provide solid current and relevant evidence that there is no trend towards increased repeat borrowing which would automatically lead to greater financial hardship. Therefore, there is no market failure indicative of requiring harsher legislation of reduced fees for subsequent loans. Additionally, as discussed in Fact 8, the Panel's Interim Report appears to have misinterpreted data presented on repeat borrowing to include irrelevant and inappropriate data by inappropriately referencing pre-

[18] Page 9 CoreData, "Loan approval rate by business model".
[19] Interim Report, page 12
[20] Interim Report, page 13

Proposed Reform Option 1	
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	SACC issues as evidence and basis for reform. The only current SACC industry wide data available and supplied to the Panel on repeat and/or concurrent loans which could inform the debate on the need for reduced fees for repeat borrowing was omitted from the Interim Report. The supplied evidence from the CoreData report shows clearly that less than 7.8% (1 in 10) of new contracts were entered into with customers with an existing contract. By consumer advocate standards, any evidence of repeat borrowing will lead to increased financial hardship. Nonetheless, CoreData evidence shows that the rates of financial hardship requests and debt collection processes leading to recovery actions are in decline (refer to Fact 7 above). **This evidence is strong confirmation that the SACC legislation is working as intended and the consumers are receiving appropriate protection from financial hardship.** In any case, proposed changes to the fee structure for repeat SACC loans cannot be instigated without modifying the fee structure of MACC's to avoid fee distortion around the $2,000 value for both SACCs and MACCs. If a consumer obtained a *second* SACC from a credit provider for $2,000, the proposal is that the maximum establishment fee would be $200. If, however, the second loan was a MACC for $2,001, the formula contained in section 32B of the National Credit Code envisages an establishment fee of $400. The Secretariat has advised no such change is occurring for MACCs. This proposed option then begs the question of why was this proposed option even included in the Interim Report? The NCPA holds no documented financial information on what such change would do. However, anecdotally, members have indicated they could not operate at such a low margin of 10% for subsequent SACCs let alone with the addition of 'Option' 2 or 3. This outcome would lead to an exodus from the SACC industry of smaller lenders which would greatly decrease market competition as well as greatly reduce the preferred way of consumers obtaining credit, i.e., through a retail outlet. This is a matter which will be of concern to the Panel. Reform Option1 is, at best, misguided as it would financially preclude consumers from dealing with their known lender and the Panel would not achieve what they appear to be wanting to achieve, i.e., reduce charges for repeat borrowers. Consumers would not benefit from this Option as they would quickly learn that they cannot simply approach their lender for a second loan as subsequent loans would not be profitable for lenders to supply. All borrowers for a 'subsequent' loan would be forced to go to another lender where they will be charged 20% on the first loan with that lender, thus defeating the intent of the reform option. Despite the unviability of such a proposal, no consideration was given in this option as to the time-frame for consideration. Was this a second loan in 90 days, 1 year, 2 years, 5 years , or another time frame?

Proposed Reform Options 2 and 3	
Option 2 Replace the rebuttable presumption that a SACC is unsuitable if a consumer has had two or more SACCs in 90 days, with a bright line test banning the provision of SACCs to consumers who have had two or more SACCs in the past 90 days.	
Option 3 Extend the protected earnings amount for Centrelink recipients, where total SACC repayments cannot exceed 20 per cent of gross income, to all consumers and lower the protected earnings amount to no more than 10 per cent of net income.	
Further Information Requested	**NCPA response**
Is policy option 2 or policy option 3 more effective at improving consumer outcomes? Please consider the cost and benefit of both options including the effect on competition, fairness, innovation, efficiency, access to finance, regulatory compliance costs and consumer protection.	Neither of these two proposed options have any basis in fact as to possibly being 'effective at improving consumer outcomes'. The NCPA can see no outcome to the benefit of consumers by imposing such a restriction. It can only see an effect of <u>placing more financial exclusion on consumers</u> than they already experience. If they can no longer (within the prescribed timeframe) get a safe, highly regulated SACC product where they are protected from debt spiral and by financial hardship considerations and will know exactly how much they will have to repay, they will seek it from an unregulated environment. Consumer advocates naïvely insist that consumers, who would be precluded from using a SACC loan because of these proposed options, can approach a NILS or LILS provider. Current and relevant evidence exists in the information provided on the website http://goodshepherdmicrofinance.org.au/ for Good Shepherd finance that their 'customers' MUST be: (a) drawn from Victoria and South Australia;[21] (b) on Centrelink benefits; (c) reside in their current premises for 3 months; (d) only borrow for specific items (this list does not include all medical, dental or vet expenses, rent or bond, or cash); and (e) specifically, cannot be for anything urgent (money required within 24 hours) as Good Shepherd states, "Please be aware processing times are currently longer than normal due to technical difficulties. We are working through all enquires and appreciate your patience." This message has been showing for at least two weeks. Furthermore, the loans are specifically <u>NOT FOR</u> Rent or Bond, Bills, Cash, or Holidays. Apart from the real and urgent need at times for loans for these stated non-eligible purposes, do we really need financial police to tell Australians that they cannot borrow money to take a holiday just because they borrowed some money a month or more ago? SACC providers and NILS and LILS providers are servicing two different sectors of the small loans market. NILS and LILS, which specifically only provide services to consumers on Centrelink benefits, can never hope to fulfil the requirements of SACC loan consumers who are employed and those (the majority of SACC borrowers) who demand urgency, flexibility, convenience, and especially the freedom to make their own financial

[21] One particular scheme offered by Good Shepherd through the website http://goodmoney.com.au/ to people on low incomes in Victoria and South Australia. Information downloaded 18/01/2016.

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<tr><td></td><td>decisions as to how to use the borrowed funds. None of these product requirements are met by providers of NILS and LILS.

The Panel, other submissions, and the Interim Report have not produced any current or relevant data for SACC consumers that showed there was any market failure that warranted change as proposed in either of these two options.

<u>On the contrary</u>, in this response, the NCPA has provided current and relevant evidence through the CoreData survey results that the current consumer protections are working. This is evidenced by:
<u>Fact 4</u> which shows that 99.95% of consumers never have a problem with SACC products;
<u>Fact 6</u> which indicates a low volume of repeat borrowing and;
<u>Fact 7</u> which demonstrates that, compliance with current very restrictive RLOs, acceptance of all or any hardship requests for cost containment, together with debt-spiral limitations, have all led to a vanishingly small number of bad debt cases going to judicial processes.</td></tr>
<tr><td>In relation to policy option 3, what percentage cap on repayments, relative to income amount, would be most appropriate to promote financial inclusion?</td><td>The NCPA supports the extension of the Protected Earnings Amount of 20% of Gross to all consumers who received 50% or more of their income from any Government benefits source including those on Veteran's pensions. However, the NCPA is adamant that the <u>cap should remain at 20%.</u> It is illogical to expect that decreasing the cap on gross income availability would "promote financial inclusion". The only effect would be to <u>increase financial exclusion</u> by taking away a source of safe and effective SACC loans.

<u>Maintaining the 20% of Gross Income rule</u> would be the most effective way of <u>maintaining financial inclusion</u> at its current level. Decreasing the cap to 10% would promote <u>financial exclusion</u> rather than inclusion as more people would be precluded from gaining SACC loans. NCPA has demonstrated that the current 20% cap as a restriction on borrowing is working well as extremely few borrowers do any of the following:
(1) contact financial counsellors (approximately .005% of consumers;
(2) contact EDR schemes except at inappropriate and illegal urging by consumer advocate groups; or
(3) find themselves in a situation of judicial processes.

The NCPA has provided evidence from CoreData (refer to Facts 4, 6 and 7) that is both current and relevant to back up these statements. On the other hand, neither the Interim Report nor any other submission to the review has provided current and relevant data for SACCs that shows there is any market failure or that financial exclusion was an issue with the gross income cap set at 20%.</td></tr>
</table>

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	NCPA has further provided evidence that NILS and LILS loan providers are particularly adept at financially excluding borrowers from their programs as well as tightly restricting the purpose for which their loans can be used and imposing unacceptable delays upon potential borrowers. All these items add up to heavy financial exclusion from these programs which do not service the needs of a vast number of consumers. As stated previously, NILS and LILS programs service a different market to that serviced by SACC loans.
Does the cap on repayments need to be broader than just SACC repayments? For example, should lease repayments and other fixed obligations also be included?	The NCPA does not hold data related to lease contracts. By "other fixed obligation" the NCPA assumes the Panel is referring to repayment obligations to all other ACL holders, including banks, building societies, credit unions credit card companies, store cards etc – as they are all captured under the NCCP for these same consumers? Is the panel suggesting all repayments from PEA consumers to all ACL holders be captured?
In relation to policy option 3, would a higher percentage of income, applied to the consumer's net income, subtracting lease repayments and other SACC or lease payments, be more appropriate? Are providers able to ascertain these figures?	This policy option describes how legislation operated before the SACC changes. That is, 100% of a consumer's income was the starting point and then all expenses including all other loan or lease costs were deducted from that income to arrive at a figure that was then deemed to be available for loan repayments. The NCPA cannot provide figures as evidence that this proposed option is warranted. Neither can the Panel or other submissions provide current and relevant evidence to support an assertion that the current restriction on gross income of 20% is not working as intended. On the contrary, **ASIC has stated the current model works well.**

<table>
<tr><th colspan="2">Proposed Reform Options 4, 5 and 6</th></tr>
<tr><td colspan="2">Option 4
Introduce a default window, where no default fees can be charged until the consumer has missed a payment by one payment cycle.</td></tr>
<tr><td colspan="2">Option 5
Maintain the current maximum amount recoverable for default of a SACC but introduce a supplementary cap to limit how quickly fees can be charged (for example, $10 per week).</td></tr>
<tr><td colspan="2">Option 6
Cap default fees as a percentage of the amount outstanding on the SACC.</td></tr>
<tr><td>Further information requested</td><td>NCPA response</td></tr>
<tr><td></td><td></td></tr>
<tr><td>What costs do lenders incur when a consumer defaults?</td><td>The NCPA does not hold data on default costs of lenders. The business model chosen by lenders will produce different cost levels with regard to defaults.

When a consumer defaults, lenders, typically, incur the following costs:-

(a) a fee from their financial institution or third party DDR provider in respect to the reversed payment (this fee can vary from a few cents to many dollars depending on individual circumstances and arrangements with their financial institution);
(b) the administrative cost of reversing the payment in their own systems;
(c) the administrative cost of file retrieval, attempting to contact the consumer, creating, and delivering required notices to the consumer; and
(d) the cost of maintaining records of all of these steps.</td></tr>
<tr><td>In relation to option 4, what are the typical payment cycles and what is the most appropriate default fee window?</td><td>The NCPA holds no data on this request, however, the NCPA would expect that most lenders would operate on weekly or fortnightly repayment cycles to suit the customer. Some customers would request a monthly repayment cycle.

NCPA's observation regarding option 4 is that it would be totally inappropriate and impractical for monthly repayment cycles.

Apply a principle of one fee per failed repayment event.

The concept of attempting to link an unrelated time cycle to a fix event is not logical.

The NCPA understands the Panel's intent in this reform as it seeks to provide a relief window for repayment defaults by SACC users. However, it is difficult to determine cut-off points based on cycles chosen by consumers; Those on a weekly cycle would typically get a week's grace before default; those on a fortnightly basis will get two week's grace; and those on a monthly cycle will get four week's grace.

For equitability and consumer understanding, the NCPA strongly advises that if any charge-free-default period is to be set, it should be</td></tr>
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	set at a maximum of 3 business days from the date the lender is advised by their bank or Direct Debit provider before applying a default fee charge. For clarity, it takes some banks and Direct Debit providers up to 3 business days to advise the lender of the dishonoured payment. This process effectively gives consumers from 4 to 7 working days to see a payment has been dishonoured and the opportunity to contact the lender and either make the payment up or arrange to make the payment up and/or trigger some form of hardship assistance. As these same SACC consumers have other financial products with other licensed ACL holders which attract the same NCCP fee default process for non-payment on a due date of a repayment, for consumer consistency and market neutrality, this 'default fee free time zone' must be applied to all other ACL holders for all products with a default fee for non-payment.
What is the appropriate level of the default caps under option 5 and 6?	**Option 5:** The NCPA does not hold any data on default fee costs. In any case, the default fee should never be below the lender's reasonable costs. **Option 6:** Default fees for low value loans have typically never been a 'percentage' of the amount outstanding. Default fee 'cost' is usually a standardised cost commensurate with the work involved with processing the default. Different types of defaults lead to different standardised processing costs. Applying a default based on percentage of outstanding loan would lead to inequitable application of costs, i.e., consumers triggering the same default type would not be treated equally as to cost of the default and an individual consumer may be charged a different fee for the same default but which may occur at different stages of their loan. The logic and methodology behind this option is, in the opinion of the NCPA, totally flawed. Potentially, a consumer could be charged various default values for the same default during the course of the same loan causing consumer confusion.

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Option 6 Cap default fees as a percentage of the amount outstanding on the SACC.	
	This model would be too difficult for the consumer to understand when applied to small amount loans. It seems that this suggestion comes from the banking sector who use this on certain home loan contracts for missed payments. **NCPA strongly asserts that lenders must be able to recover costs.**
If you are a SACC provider, please also provide evidence of the actual costs that you incur as a result of a consumer's default.	Different business models will produce different standardised default processing costs. The NCPA does not hold any data on the cost of consumer defaults as incurred by its Members.

Proposed Reform Options 7 & 8	
Option 7 Provide SACC consumers with a benefit for early repayment by specifying the reduction in payment that would arise from early repayment of a SACC (whether in full or in part).	
Option 8 Require SACCs to have equal repayments over the life of the loan, while still allowing consumers the ability to pay off a SACC early.	
Further information requested	**NCPA response**
Should lenders under a SACC be required to provide consumers with a benefit for early repayments of the balance and, if so, how should any such requirement operate?	NCPA understands that this option may be an attempt to counter problems from a situation where some lenders' models charged all the monthly 4% fees for the expected duration of the loan at the inception of the loan. The NCPA asserts that the whole premise and logic of this question is wrong. The Panel's suggestion is attempting to manage an event that can be prevented in the first place. Any irregularities in the timing of repayments can be overcome by a very minor change to the legislation. This very minor change would

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	be to clarify that the monthly fees for the term of the loan, cannot be charged upfront at the loan inception and can only be charged on the monthly anniversary day of the loan issue date. This minor rewording would remove entirely any issue related to the monthly fees when a loan is repaid early. **IMPORTANT NOTE: This process of charging monthly fees in advance was something Treasury confirmed could be done and was also confirmed by several law firms. It must also be pointed out that lenders using this monthly-fee-upfront model were operating within existing law, at least as it was understood by several law firms and Treasury itself.**
Should the same requirement apply to both the fee-splitting model and where the loan is repaid in full early?	If the "fee-splitting model" is that by which the majority of the debt is repaid in the early part of the loan with the balance paid by smaller repayment amounts later in the loan[22], the NCPA can see no reason why there should not be some benefit given to a consumer for early repayment. This might be achieved by assuming equal repayments over the period of the loan – whilst considering the comments below.
Are there circumstances in which SACC providers require consumers to make repayments for different amounts? If so, in what circumstances is this done and what is the difference in the size of repayments?	The NCPA believes it is entirely appropriate to require SACCs to have equal repayments over the life of the loan but at the same time still allowing consumers the ability to pay off a SACC early or delay and reduce payments as required, and as agreed with the credit provider. The NCPA believes that there are legitimate circumstances where a lender may apply a different repayment amount other than the one first established. These circumstances are legitimate outcomes of supplying credit to individuals with individual credit needs. One such situation is where a consumer may urgently need funds today but has an existing loan. Existing repayment commitments for this existing loan would normally prevent an extra loan as it would require higher fixed repayments amounts than the consumer could sustain at that point in time. At the consumer's request, their needs could be met by lowering the usual fixed combined repayment amount for a number of weeks or months. The consumer can, at any time, change to a higher repayment amount per week for the remainder of the loan. This means that the loan runs slightly longer than normal but it will meet the consumer's individual requirements. This highlights the valid situation where a consumer may need two (or

[22] As is suggested by the Interim Report, page 17

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Require SACCs to have equal repayments over the life of the loan, while still allowing consumers the ability to pay off a SACC early.</td></tr>
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Legislators will never be able to "second guess" the millions of consumer situations that require flexible repayments at a consumer's request to meet their particular credit needs.</td></tr>
<tr><td>To what extent do SACC providers charge fees in respect of outstanding months when a consumer repays a SACC early?</td><td>The NCPA does not hold any data on this issue.

The NCPA has discussed a solution to the Panel's perceived problem of early payout penalties in respect to timing of the 4% monthly fee. NCPA is not aware of situations where lenders recoup unmet expected monthly fees because a customer paid out early.</td></tr>
</table>

APPENDIX A

Financial Compliance Requirements

The table below compares the compliance requirements for all types of short, medium and long term debt including SACCs, credit cards and mortgages.

(Data supplied courtesy of Nimble)

	Short-term debt		Medium-term debt (up to 2 years)	Long-term debt	
	SACCs (Unsecured)	Credit Cards (Unsecured)	MACCs (Secured and unsecured)	Personal Loans (Unsecured)	Mortgages (Secured)
Amount of loan	Legislative limit (capped $2,000 principal)	Agreed limit (uncapped)	Legislated limits ($2,001 to $5,000)	Agreed limit (uncapped)	Agreed limit (uncapped)
Responsible lending obligations					
Make reasonable inquiries about the consumer's requirements & objectives in relation to the credit contract	✓	✓	✓	✓	✓
Make reasonable inquiries about the consumer's financial situation	✓	✓	✓	✓	✓
Take reasonable steps to verify the consumer's financial situation	✓	✓	✓	✓	✓
Other obligations					
90 day bank statements	✓	⊘	⊘	⊘	⊘
Presumption of unsuitability	✓	⊘ Note: consumers may be in a debt spiral as there are no limits on the number of credit cards a consumer may have. There are no obligations for a consumer to close off other credit cards in the event that they transfer the balance of credit to another credit card provider.	⊘	⊘	⊘
Fee prohibitions for refinancing	✓	⊘	⊘	⊘	⊘
Restrictions on fees and charges	✓	⊘	⊘	⊘	⊘
Protected Earnings Provision	✓	⊘	⊘	⊘	⊘
Suitability Assessment	✓	✓	✓	✓	✓
Requirements for warning on licensee's website	✓	⊘	⊘	⊘	⊘
Credit limit increases	Prohibited as each loan is assessed on its own merits.	Permitted provided the consumer consented to the credit limit increase. Note, no express requirement for each credit limit increase to be assessed on its own merits.	An asset can be "pledged" as collateral for certain loans.	Permitted subject to lender's lending criteria. Note, no express requirement for each credit increase to be assessed on its own merits.	Permitted but refinance assessed on its own merits.
Fee Cap	✓ 20% Est. Fee 4% Monthly Fee	⊘	✓ $400 Est. Fee 48% APR	⊘	⊘

PAYDAY LOANS = BANNED