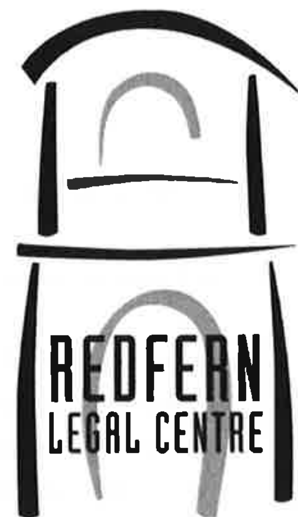
Redfern Legal Centre



22 January 2016

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

By email: consumercredit@treasury.gov.au

Dear SACC Review Secretariat,

Thank you for considering our submission in response to the Review of Small Amount Credit Contract Laws and Comparable Consumer Leases ('SACC Review').

The Interim Report published by the Committee in December 2015 (Interim Report) represents significant step forward in addressing the harm caused to vulnerable consumers who access these financial products. We believe that enhancing consumer protection and compliance measures is the most effective way to ensure the long-term viability of the industry, for consumers and industry alike.

Redfern Legal Centre ('RLC') welcomes the observations made by the Committee in the Interim Report and appreciates the opportunity to contribute further to the Review.

Yours faithfully,
Redfern Legal Centre

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Interviews by appointment: Monday to Thursday 6.30pm – 8pm

Chapter 1: Overview and background

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

In our casework experience at the RLC, we have observed that consumers who are reliant upon Centrelink income make up the predominant market for consumer leases. Consumer leases tend to be a common means of obtaining basic consumer goods (such as fridges, washing machines, televisions and laptop computers) for vulnerable people, who have a misguided belief that these are affordable or 'fair go' arrangements. We have observed that these consumer leases tend to be obtained directly in store, rather than online.

Similar findings that support this observation were made in the Australian Securities and Investment Commission Report 447 into the cost of consumer leases. This report found that Centrelink recipients were most likely to be charged more than the maximum amount payable.[1] Obtaining goods in store often results in the high-pressure sales tactics, and the levy of costly and unnecessary add-on products, such as insurance and 'Damage Liability Reduction' fees. Many of these consumer leases would be deemed unsuitable if the provisions of the SACC responsible lending requirements were properly applied to consumer leases.

Chapter 3 – SACC Provisions

Repeat Borrowing

The RLC is in agreement with the Committee that the continued high levels of repeat borrowing tend to suggest that the rebuttable presumptions have failed to meet their desired objectives. The three policy options all present practical considerations to improving the deficiencies under current presumption tests. We are supportive of Option 2 and 3 being implemented, however we note that all three options together would have the greatest utilitarian effect in eliminating recurring debt spirals.

<u>Option 1</u>

Reduce the establishment fee for subsequent loans for returning customers from 20% to 10%.

We are in agreement that the 20% establishment fee for subsequent loans should be reduced. Evidence presented to the Committee demonstrates that the current cap is being applied irrespective of whether the applicant is an existing or new borrower. This practice disadvantages those consumers who hold pre-existing products. The net effect of this arrangement also promotes an incentive for SACCs to engage in repeat lending practices in order to generate more profitable returns. A decrease in subsequent establishment fees is necessary in order to curb manipulation by SACCs providers.

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[1] Australian Securities and Investment Commission Report 447: 'Cost of consumer leases for household goods', September 2015.

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 to SACCs to consumers who have had two or more SACCs in the past 90 days.

The RLC reiterates our first Submission of an unequivocal restriction on repeat borrowing.[2] We strongly support the introduction of a bright line test banning the approval of SACCs to a consumer who has had two or more SACCs' in the past 90 days. The submissions received from consumer groups, community legal centres and the banking industry are overwhelming in favour of reducing access to multiple SACCs products at any one time.

A bright line test would be a simple and effective mechanism to protect vulnerable consumers, who in our experience suffer the greatest instances of default rates and recurring debt cycles. Eliminating the accessibility to these products restrict recidivist debt patterns and assist in avoiding a spiral of debt.

Option 3

Extend the protected earnings amount for Centrelink recipients, where total SACC repayments cannot exceed 20% of gross income, to all consumers and lower the protected earnings amount to no more than 10% of net income.

We welcome the proposal for a 10% net income rule for repayments. It is our view that Option 3 would generate the largest consumer benefit and do so most efficiently. The 10% net income rule would be the most effective mechanism to protecting vulnerable consumers from instances of default and recurring debt. Applying this protected earnings rule to net income would provide a more accurate account of the applicant's discretionary income.

Our casework regularly shows that the assessment of income fails to properly attribute basic living expenses (such as utilities, medical bills, childcare etc.) in the assessment process. Implementing a net income calculation provides a true indication of the applicant's financial status and the true (un)suitability of the loan.

Further Information

Is policy Option 2 or Policy Option 3 more effective at improving consumer outcomes?

In line with our response above, we believe that adopting both proposed Policy Options would significantly enhance consumer protections and promote better compliance with responsible lending requirements. Repeat borrowing behaviours fuel the recurrence of debt cycles. The detrimental impacts on consumers that find themselves in a reoccurring debt spiral significantly outweigh the capital gains made by credit providers.

The proposed legislative amendments are minimal and the cost to amend existing practices is cursory. The crux of these proposals is already in place today and will not impose any major regulatory compliance costs to industry if these changes are adopted.

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[2] RLC Submission, October 2015 p 6.

In relation to policy option 3, what percentage cap on repayments, relative to income amount would be most appropriate to promote financial inclusion?

In line with our Submission and response to Option 3 above, we support the proposed 10% net income rule. The RLC believes that the amount of protected earnings or income should align with the Centrelink Code of Operations, where a maximum of 10% of welfare payments can be assigned to making repayments towards debt.

Our casework surrounding SACCs and consumer leases have shown us that 20% of a Centrelink recipient's income directed towards debt repayments is too far high, and that making repayments under these terms leads to harm and exclusion. Given the diminutive rates of payments most Centrelink recipients receive, we believe 10% net income is a realistic figure.

Does the cap on repayments need to be broader than just SACC repayments?

Yes, we are supportive of a cap on repayments being extended to other financial instruments, consumer leases in particular. The cap on repayments proposal encourages the financial service provider to conduct a more genuine appraisal of a consumer's financial position, and the (un)suitability of the products they are offering in this context.

The cap on repayments approach is an effective mechanism to ensure that vulnerable consumers can manage the cost of these financial products without having to sacrificing their basic living expenses.

Default fees

The RLC supports a cap being placed on default fees and agree that Options 4 and 5 would seek to address the inflated fees that are currently imposed on borrowers when they default on their repayments. We have observed through our casework that default and recovery fees are being charged in a manner that significantly disadvantages vulnerable consumers.

What is the appropriate level of default caps under Option 5 and Option 6?

We believe that Option 5 produces the most effective outcome for consumers. Limiting the rate at which default fees can be charged will avoid the exponential increase in default fees that are charged in the event of a borrower defaulting.

Our casework experience shows us that default fees and charges can often exceed the cost of recovery and enforcement, and present a significant barrier to the fair resolution of defaults due to financial hardship. Capping the default fees proportionate to the default amount represents a fair appraisal of liquidated damages and produces the fairest outcome for both lenders and borrowers.

Although Option 6 calculates the cap based on the true debt amount that is owed, we believe this does not produce the most cost effective outcome for borrowers. Capping default fees as a

percentage on the amount outstanding has the effect of disadvantaging those borrowers with larger adjusted credit amounts and will prolong the repayment of the debt.

Anomalies arising from the Small Amount Credit Contracts Cap

We support the practice of incentivising borrowers to repay their debts sooner. A combination of Option 7 and Option 8 are encouraging mechanisms that will reduce the amount of debt payable in the long term and prevent the exploitation of SACC providers who seek to force the borrower to repay more upfront.

Further Information

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 requirements operate? Should the same requirement apply to both the fee-splitting model and where the loan is repaid in full early?

The RLC supports the adoption of an early repayment incentive. For example, most retail energy providers offer a 5% discount if an account is paid before the due date. These strategies promote a financial incentive for the consumer to remain in control of their debts, while reducing the cost of the loan in the long run. Similarly, it is also more commercially viable for lenders to receive early repayments, albeit at a marginally reduced amount.

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?

While we cannot cite any specific casework examples, it is our position that there should not be any differentiation in repayments across the term of the loan. Most standard credit contracts do not require the borrower to pay more upfront. The cost of the loan and any fees payable should be evenly spread out across the life of the loan and not structured in a way that enables the lender to secure more money at the outset. The RLC believes that SACCs which structure repayments in this way inevitably lead to higher instances of default.

To what extent do SACC providers charge fees in respect of outstanding months when a consumer repays a SACC early?

As noted above, we believe it is important for SACC providers to incentivise early repayment. We do not consider it fair or appropriate for SACC providers to penalise early repayments and note that structuring SACCs in this way discourages consumers from proactively managing their financial affairs, promotes a protracted and evasive approach to managing these financial products and increases the risk of recurrent debt spirals.

Chapter 4: Consumer Leases

Cap on Consumer Leases

A number of the Submissions evidence the growing financial harm which consumer leases are causing, predominantly to vulnerable consumers reliant upon Centrelink income. The RLC shares

the views articulated in Perspective I of the Interim Report. We agree that greater regulatory protections must be implemented to better protect vulnerable consumers from the financial harm inherent in these products. Through our casework experience, we have observed that a majority of our clients who access consumer leases are reliant upon Centrelink income. This vulnerability is commonly compounded by mental illness and cognitive impairment, long-term unemployment and has poor financial and literacy skills.

In our experience, most consumers have no genuine understanding of the onerous terms on which they access these basic consumer goods. Consumer lease providers take advantage of this imbalance in bargaining power to create onerous and exploitative contractual terms. To reduce the harm created by the consumer lease market, it is crucial that more effective regulatory protections are implemented.

Further Information

All other products regulated by the Credit Act are subject to a cap on costs. Is there any reason why users of consumer leases for low-value household or electronic goods should not have the benefit of this protection?

The RLC is firmly of the view that a maximum cap on the cost of consumer leases should be applied. We see no rational reason why a cap should not be applied to these products. Research has continued to show that the fees charged by lenders are more than sufficient to deliver the financial product to consumers. Evidence submitted by National Australia Bank reveals that there is in fact potential to reduce the costs charged to consumers even further.[3]

If a cap on the cost of leases were to be introduced, is there a reason for lessors not to be subject to the 48% cap that applies to credit contracts in general?

In line with our previous Submission, we believe a cap of 48% should apply across all credit contracts and there should be no carve out exceptions for consumer leases. We see no substantial difference between consumer leases and other credit contracts where this cap applies. Creating a single uniform interest rate cap will increase efficiency and reduce the regulatory burden on the industry and lenders.

Should there be a limit on the maximum term of a consumer lease?

Yes, a maximum term of two to three years should be introduced. In our experience, we often see consumers under these lease agreements continuing to pay fees more after the term of the lease has expired. This is often through open-ended Centrepay and direct debit deductions. There have been occasions where these repayments continue indefinitely and where lease providers have failed to notify consumers of a right to purchase the goods at the end of the lease agreement.

If a cap on the cost of leases were introduced, which types of leases should the cap apply to?

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[3] National Australia Bank Submission, October 2015, pg. 3.

We propose that a cap should apply to leases of an amount of $2,000 or less. Consistent with the responsible lending obligations that are imposed on SACCs, we believe this represents a fair balance between small amount consumer contracts and medium amount consumer contracts.

How should the cash price for determining a cap on lease be determined?

It is difficult to develop a simple formula for assessing the cash price of goods in this context. There is added complexity when second-hand or older model goods are being sold.

We support the detailed proposals set out in the submissions of Legal Aid NSW, Financial Rights Legal Centre and Consumer Action Legal Centre on this question.

Add-ons

The RLC submits that all add-on features should be included in the total cap cost of the consumer lease. This includes repairs, replacement and maintenance. There is a high risk that add-on features are prone to exploitation and avoidance, if not capped appropriately. Our experience has shown that some providers are using avoidance tactics to levy unreasonable add-on fees and charges. We believe that all add-on charges should be encompassed in the 48% cap, and that it is reasonable for consumer lease providers to bear this costs given the nature of their business.

We accept that there may be some add-on features that are not performed by the goods provider, delivery costs in particular. A carve out provision for delivery costs may be permitted provided that delivery costs are reasonably and appropriately calculated. One solution could be to adapt a two pronged delivery cost for the Sydney metro area and regional or rural New South Wales. We support the implementation of a cap on regional areas of $300. This cap would ensure that consumers are not discriminated against based on their locality and that delivery charges represent the actual cost incurred by the business.

Lease Affordability

Further Information

Are stakeholders able to provide information on whether there are broad or systematic problems with the way in which lessors comply with the responsible lending requirements in relation to low-income consumers and Centrelink recipients?

Yes, there are systematic failures under the current regime that result in low-income earners, particularly those reliant upon Centrelink income, not being properly assessed in accordance with responsible lending requirements. The extent of inquires made to verify income are routinely inadequate and do not properly recognise the high cost of basic living expenses. In our casework experience, we regularly encountered assessments that fail to conduct reasonable inquiries about income, living expenses and other liabilities and, in turn, fail to properly assess suitability.

Should a protected earnings amount be introduced for lease, similar to Option 3 canvassed in relation to SACCs?

Yes, we believe that a protected earnings amount should be introduced for leases, in the same way they apply to SACCs, for the same reasons they apply to SACCs.

If a cap restricting the amount of income that can be used to make lease repayments were introduced, what level would be affordable for consumers and lead to financial inclusion?

We support the proposal for a 10% net income cap as the maximum amount that can be used to make lease repayments.

Early Termination Fees

Based on our experience at the RLC, standard consumer lease agreements routinely include onerous and excessive early termination fees. We have encountered examples where an early termination clause exceeds the total cost of acquiring the product. In our view these types of inflated early termination fees do not genuinely pre-estimate the loss suffered by the consumer lease provider, fail to mitigate potential loss and amount to a penalty.

The below extract illustrates this example. This is a clause extracted from Radio Rentals standard form Consumer Lease Agreement for a period of 18 months:

"**Early Termination Fee**" is:

(A) Where this contract is a Consumer Lease the sum of the following amounts calculation at the Calculation Date, and

(i) where the Lease Period is 18 months or less:

(a) the lesser of 95% of the outstanding balance of the Total Rental Amount or

1. six months Rental Amount if the Contract is for brand new Goods or New Condition Goods
2. three months Rental Amount for Contracts for all other categories of Goods

and

(b) our reasonable expenses in attempting to recover the Goods.

Where the consumer lease provide can charge a termination fee of 95% of the contract cost, there is significant imbalance in bargaining power and barriers to exit which prevent many consumers from terminating these arrangements on fair terms. Given the difficult of applying the Australian Consumer Law (ACL) to consumer lease and credit products, we believe that additional regulations governing consumer lease agreements should reflect the unfair contract terms provisions in Part 2-3 ACL.