



5 September 2011

By email: creditenhancementsbill@treasury.gov.au

The General Manager
Retail Investor Division
The Treasury
Langton Crescent
PARKES ACT 2600

Exposure Draft -- National Consumer Credit Protection Amendment (Enhancements) Bill 2011 -- Small Amount Credit Contracts

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on this exposure draft bill.

Broadly, we support these amendments. The proposed reforms indicate the Government is serious about addressing the harm caused to Australian consumers by short term high cost lending. If enacted, this bill will greatly improve the protection currently available for many Australians, given the current patchy and inconsistent regulatory approach of the various States and Territories to this issue.

Consumers in states and territories without effective regulation in this area -- Victoria, South Australia, Tasmania, Western Australia and the Northern Territory -- will be unequivocally better off. Consumers in New South Wales, Queensland and the ACT are currently protected by a 48% comprehensive interest rate cap (fees and charges are included for the purpose of calculating the effective interest rate).

The cap model the Government has chosen (10 per cent establishment fee plus a 2 per cent monthly fee) is to our knowledge untested. For this reason, we still believe the proven solution of a comprehensive interest rate cap set at 48 per cent per annum is the best way to cap costs of high cost short term credit. However, in either case, active enforcement to deter and punish evasion of the provisions is key to their success.

We have two key measures for the success of reform in this area:

- A reduction in harm caused by high cost short term loans, including a reduction in fees and effective interest charged; and
- A significant decrease in the number of these loans, in particular at the very short term end of the market and for basic living expenses.

We consider that the Bill if enacted and enforced can satisfy those measures. Further comments are provided below.

Consumer Action Law Centre

Level 7, 459 Little Collins Street Telephone 03 9670 5088
Melbourne Victoria 3000 Facsimile 03 9629 6898

info@consumeraction.org.au
www.consumeraction.org.au

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

Since September 2009 we have also operated a new service, MoneyHelp, a not-for-profit financial counselling service funded by the Victorian Government to provide free, confidential and independent financial advice to Victorians with changed financial circumstances due to job loss or reduction in working hours, or experiencing mortgage or rental stress as a result of the current economic climate.

About the problem

High-cost short term loans (often described as 'payday loans') are commonly for amounts between \$200 and \$500, advanced to individual consumers and are designed to be paid back within a short period of time, generally 2 to 4 weeks. These loans are very expensive -- typically attracting an equivalent annual percentage rate of 400% or more.

High-cost short term loans are harmful because, where used other than as a one-off, they worsen rather than improve the consumer's financial position. Although these loans are marketed as a one-off solution to temporary problems, evidence from Australia and the US indicates that repeat borrowing is common and necessary for viability of the lenders' business¹.

High-cost short term loans are predominantly taken out by low income borrowers to pay for basic expenses. Consumer Action's 2008 research found that 73% of borrowers earned less than the average wage, 51% earned less than \$40,000 per annum and 23% less than \$20,000 per annum.² Twenty-two per cent of borrowers used the money to pay for car repairs or registration. The next most common reason was to pay utility bills (21%), followed by food or other essentials (18%) and then rent (11%).³ In total, payment of basic living expenses was the reason for 75% of borrowing.⁴

Providers of high-cost short term loans use direct debit agreements to secure payment of instalments and withdraw the debt repayment as soon as pay or benefits are deposited into the borrower's account. When a borrower is already on a limited income, this impinges on their capacity to pay for essentials like food or rent, prompting additional financial stress and further borrowing.

¹ For example, Cash Converters International's 2006-07 Annual Report stated that the "vast bulk" of their lending business was conducted with repeat customers. Regarding traders in the US, see Consumer Action Law Centre (2010) *Payday Loans: Helping Hand or Quicksand?* p 126. Available from <http://www.consumeraction.org.au/downloads/PayDayLendingReport-FINAL.pdf>.

² Consumer Action Law Centre (2010), pp 53-4.

³ Consumer Action Law Centre (2010), pp 59-60.

⁴ Consumer Action Law Centre (2010), p 6.

The combination of customers using loans to meet basic recurring costs and lenders requiring payment by direct debit actively promotes repeat borrowing and spirals of debt for low income borrowers.

Disclosure

We note that the draft bill does not require providers of a small amount credit contracts to disclose the interest rate under the contract as is ordinarily required by subsections 17(4) and 17(6) of the National Credit Code. While we understand why this exemption is required (no interest will be able to be charged on a small amount credit contract) it is important that lenders are still required to express cost of credit under these contracts as an annual percentage rate. This will allow consumers to compare costs with other credit products on the market.

We are concerned that the cap on costs introduced by the exposure draft bills could inadvertently reduce transparency as it does not regulate cost of credit on an annual percentage rate basis. For example, even a consumer with average levels of financial literacy may mistake the 2 per cent monthly fee as being an annual rate and so compare a small amount credit contract favourably compared to mainstream credit products.

We recommend that the bill be amended to require that, where a small amount credit contract is advertised, cost of credit must be stated as an annual percentage rate, not as 10% establishment fee and/or 2% monthly fee. For example, lenders should not be permitted to advertise the cost as '10% upfront and a 2% monthly fee', which (though accurate in itself) will mislead consumers by making the product appear cheaper than it is, and make comparison with other credit products nearly impossible.

Penalties for breach of cap: section 24

Proposed subsection 24(1A) provides that a credit provider who imposes a fee or charge apart from those allowed in subsection 23(1A) can receive a criminal penalty of up to 100 penalty units. While we welcome the availability of the criminal penalty, civil penalties need also to be made available.

Where a consumer is in dispute with a lender, the availability of civil penalties means that allowing a dispute to reach court carries more risk for lenders and so provides a greater incentive to settle. Criminal penalties can only be handed out when a hearing follows an application by the regulator.

We recommend that subsection 23A(1) be listed as a 'key requirement' for the purposes of section 111(1) of the National Credit Code. This will allow civil penalties to be imposed for a breach of subsection 23A(1) on application by either the debtor, a guarantor or ASIC.

Requirement that establishment fees reflect only reasonable costs: s 31A(1)(a)

While we agree that lenders should not be permitted to charge establishment fees beyond the reasonable costs of the lender, we do not believe that this prohibition will be easy to enforce, given the small amounts involved in individual cases relative to the cost of enforcement activity and the difficulty in establishing underlying (and potentially different) costs for different businesses. However provision of guidance as to reasonable *types* of costs that may be considered in establishing 'reasonable costs' and *level* of costs that may be considered reasonable (or unreasonable) may aid compliance and provide a basis for enforcement where departure from the guidelines can be established.

We recommend that:

- guidance be provided on what costs are reasonable (for example through regulations or an ASIC regulatory guide); and
- lenders be required to provide customers with a statement setting out the establishment costs covered by the fee.

Default fees: s 39B

We understand that the intent of section 39B is to provide that the maximum amount that can be recovered by a lender in the event of a default is twice the principal loaned. However, it is possible that this section could be misunderstood to mean that a lender may charge a stand-alone default fee of that amount, and that the lender can also recover any other charges under the contract.

We recommend that the explanatory memorandum makes clear that the amount recoverable by the lender under section 39B is the total amount recoverable including all other fees and charges, rather than an additional fee.

Prohibitions on refinancing (sections 124C and 133CC) and simultaneous loans (sections 124B and 133CB)

We strongly support the policy intent behind the prohibitions against refinancing and issuing simultaneous loans as these practices drive or exacerbate consumer harm caused by high cost short term lending. However we do not consider the prohibitions will be enforceable or effective in practice.

For example, the ban on refinancing at 133CC (and the ban on assisting a consumer to apply for an increase at 124C) will not prevent a borrower from paying off one small amount contract and then taking out another a few minutes later. This would clearly cause the same harm as refinancing. We would argue that receiving a new loan within the same pay period as paying off the last loan has the same effect as a rollover -- in both cases the consumer starts their new pay period with a new loan and all repayments yet to be made.

If a ban on refinancing is to work, it will need to be complemented by restrictions on repeat borrowing. Repeat borrowing could be defined as providing a small amount loan (or assisting a consumer to access a small amount loan) within a defined period after the consumer had

terminated a previous small amount loan. We suggest that the period in question should be the greater of a fortnight or the borrower's pay period.

The prohibition on providing a loan where the lender knows, or is reckless as to whether the consumer already has a short term credit contract at section 133CB (and the mirror ban for credit assistance providers at 124C) also seems unenforceable. It is unclear what investigations a lender will need to make to be properly satisfied that a borrower is not already party to a small amount loan. Without guidance on what investigations must be conducted, it will be difficult to establish that a lender was in breach.

It is also unclear how compliance with these provisions will be monitored, noting that a consumer would be very unlikely to report a lender who breached them.

We recommend that:

- the bill is amended to include a prohibition on repeat borrowing to complement the refinancing bans at section 124C and 133C; and
- the bill is amended to include a regulation-making power for sections 133CB and 124C, and create regulations which describe the investigations that must be made by a lender or a credit assistance provider.

Consumer leases

Legislation was recently drafted to amend consumer lease provisions in the National Credit Code. The broad purpose of this reform was to prevent 'regulation shopping' by ensuring that consumer leases and consumer credit were regulated in the same way.

Assuming the caps under the small amount credit contracts exposure draft are introduced (that is, the restrictions at sections 23A and 31A for small amount credit contracts and 48% cap at subsection 32A(1) for other loans) consumer leases will again be less closely regulated than credit. It is important that these cost caps also apply to consumer leases to ensure regulation of leases and credit remains consistent.

We recommend that the consumer leases provisions in the National Credit Code be amended to ensure the same cost caps applicable to credit also apply to leases.

Application to Credit Assistance Providers

We recommend that the exposure draft bill be amended to provide that persons who provide credit assistance by arranging or suggesting a credit contract in breach of either of the caps should be subject to the same sanctions as the credit providers.

Other protections

In addition to consumer protections proposed by the exposure draft bill we recommend the bill be amended to also:

- prohibit lenders using “employer authorities” to secure repayment of a loan—any garnishing of wages should only be done in accordance with court-supervised processes. In our experience, customers are frequently required to sign documents authorising their employers to garnish wages at the request of the lender;
- prohibit contracts requiring loans to be repaid in a single repayment period and/or prohibit contracts from requiring any one repayment (including any fees or charges, including default fees) being greater than the principal borrowed. This recognises that single repayment loans pose the greatest harm to consumers;
- prohibit lenders requiring the signing of a direct debit authority and/or requirement for lenders to offer a range of repayment mechanisms—not just direct debits. This recognises that payday loans are commonly repaid by direct debits which remove payments from the debtor's account as soon as payment is deposited. Where a borrower has insufficient income to both repay debt and buy essentials, direct debit authorities ensure the debt is prioritised leaving them unable to pay for rent, groceries and utilities. This ensures that lenders wear little risk of losing their money on even the most irresponsible loans. In turn, this removes financial incentives to loan responsibly and actually creates incentives for irresponsible lending by encouraging repeat borrowing.

Please contact David Leermakers on 03 9670 5088 or at david@consumeraction.org.au if you have any questions about this submission.

Yours sincerely

CONSUMER ACTION LAW CENTRE



Catriona Lowe
Co-CEO



David Leermakers
Policy Officer