

13 June 2008

By email: lynn.kirk@justice.vic.gov.au

Robin Scott MP
Small Amount Cash Lending Inquiry
Consumer Affairs Victoria
121 Exhibition Street
MELBOURNE VIC 3000

Dear Mr Scott

Small Amount Cash Lending Inquiry

Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to make this submission to the Small Amount Cash Lending Inquiry (the **Inquiry**). In our view, most commercial small amount cash lending, which includes pay day loans, is exploitative of low-income and vulnerable consumers and can contribute to social exclusion. While in some very limited circumstances such lending might assist a consumer (through, perhaps, helping them with cash flow problems), it is our experience that most pay day lending exacerbates rather than assists consumers' debt problems.

As you may be aware, Consumer Action has been funded by the Consumer Credit Fund (**CCF**) to produce empirical research about the impact of high-cost, small consumer loans in Australia. In particular, this research aims to identify the main purpose of these loans and the short and long term impact on individuals who obtain these loans. The project will also produce critical research, examining the impacts of these loans in other countries, approaches to regulation and the economic and regulatory arguments for and against the imposition of price controls on consumer credit.

As a condition of the CCF funding, Consumer Action agreed to provide a draft literature review as well as raw survey data to the Inquiry. A draft literature review is included as Attachment A to this submission and the raw survey data is included as Attachment B. The draft literature review includes a comprehensive analysis of many of the influential academic and other writings on price regulation of consumer credit and concludes that a comprehensive interest rate cap would be beneficial not only to vulnerable borrowers but also would not adversely impact the economy or society as a whole. We envisage the final report, which will include a detailed analysis of the survey data, to be completed by the end of 2008.

In the remainder of this submission, we will:

- Detail some of the main findings of the consumer survey;
- Comment on some of the regulatory options available, looking particularly at the regulation developed in New South Wales and Queensland; and
- The benefits of national consistency.

Consumer survey findings

As part of the CCF project, Consumer Action contracted Pure Profile, a research company, to undertake surveys with payday loan borrowers. For the purposes of our study, we defined a payday loan as a cash loan of under \$2,000, from a registered institution, that must be repaid within a 2 month period. While we recognise the scope of the Inquiry is broader (ie, there is no minimum time period), we wanted to analyse loans that are more akin to payday loans, and not other small amount loans, for example a store arrangement for the purchase of furniture or a fridge.

We obtained 448 interviews during May 2008. A full copy of the questions asked as part of the study is included at Attachment C. Some highlights from the survey results include:

- 25% of loans were for less than \$500 and 60% of loans were for less than \$1000
- 60% of the loans were with Cash Converters
- The main purpose of the loans were:
 - Car repairs (22%)
 - Utility bills (21%)
 - Food or other essential expense (17.6%)
 - Rent (10.7%)
- 28% of borrowers have reported that they have taken out another payday loan to pay for a payday loan (20% with the same lender)
- 24% of respondents were single, 30% were a couple with children, and 10% were single with children;
- 23% reported their income as less than \$20,000, 51% were less than \$40,000 and 72% were less than \$60,000.

The purpose of the majority of these loans indicates that the credit is primarily used to supplement income. In fact, less than 5% of the loans were for the purchase of a lasting item or payment for once-off payments that don't necessarily involve financial hardship (such as holidays). It is our view that this need to use credit for general living expenses would be an indicator to a lender that the borrower would not be able to repay the loan without undue hardship.

This sort of indication may mean that the loans are unjust under the Uniform Consumer Credit Code (**UCCC**). Section 70 of the UCCC provides that a consumer can challenge a credit contract as unjust and that the court can re-open the transaction. One factor that the court can consider in determining whether a credit contract is unjust is 'whether at the time the contract was entered into or changed, the credit provider knew, or could have

ascertained by reasonable inquiry of the debtor at the time, that the debtor could not pay in accordance with its terms or not without substantial hardship'.¹

As the attached literature review demonstrates, the experience from United States is that most pay day loans do not resolve short-term financial difficulties. The fact that many consumers rollover loans, or that numerous loans are taken out over a period of time, indicates that the lending may actually exacerbate, rather than alleviate, financial hardship. Further, as suggested in the literature review, there is a real concern that the easy availability of pay day loans drives their demand. The experience of jurisdictions where effective interest rate caps are introduced supports this – there is not increased consumer hardship after the pay day lending industry is effectively regulated.

Further analysis of these issues, and a more comprehensive analysis of the survey data, will be completed as part of our final report.

Regulatory options

Victoria currently has an interest rate cap of 48% on unsecured lending and 30% on secured lending.² However, lenders are able to evade this regulation by casting the cost of credit as fees and charges. While Consumer Affairs Victoria have sought to challenge excessive fees imposed by cash lenders, such action has not been successful.³ Unsuccessful decisions have left regulators, consumers and courts impotent to challenge excessive fees and charges. Consumer Action's casework practice continue to see many consumer credit contracts evade this consumer protection by charging large fees and charges.

New South Wales and the ACT are the only jurisdictions to have a comprehensive maximum interest rate cap on consumer credit which is designed to close this loophole. Queensland has enacted legislation that will enable the introduction of a comprehensive interest rate cap, but the relevant regulation has not been enacted yet in the Queensland parliament.⁴ This is foreshadowed to happen later this year.

It is worth noting that in all those jurisdictions a very similar approach is made to fixing the maximum allowable cost of credit at 48% per annum.⁵ Each of these regulations finds its head of power in the relevant state's consumer credit legislation in a form as follows:

The regulations may require interest charges and all credit fees and charges under a credit contract or class of credit contracts to be included for the purpose of calculating the maximum annual percentage rate under the credit contract.⁶

¹ Uniform Consumer Credit Code, section 70(2)(l).

² *Consumer Credit (Victoria) Act 1995* (Vic), sections 39 and 40.

³ See, eg, *Director of Consumer Affairs v City Finance* [2005] VCAT 1989.

⁴ *Consumer Credit (Queensland) and Other Acts Amendment Act 2008* (Qld).

⁵ See *Consumer Credit (New South Wales) Special Provisions Regulation 2007* (NSW), reg 6 and 7; *Consumer Credit Regulation 1996* (ACT), reg 5 and 6; consultation draft of *Consumer Credit (Queensland) Special Provisions Regulation 2008* (Qld), re 2 and 3.

⁶ See, eg, *Consumer Credit (New South Wales) Act 1995*, section 11(2).

The relevant regulation from NSW then states (other jurisdiction's regulations are very similar):

6 Maximum annual percentage rate

(1) The maximum annual percentage rate for a credit contract to which the Code applies is 48 per cent.

(2) For the purposes of section 11 (2) of the Act, interest charges and all credit fees and charges under a credit contract are to be included for the purpose of calculating the maximum annual percentage rate under any credit contract to which the *Consumer Credit (New South Wales) Code* applies.

(3) The maximum annual percentage rate is to be calculated in accordance with clause 7.

(4) Despite subclause (2), any credit fees or charges arising from the establishment or maintenance of a temporary credit facility are not required to be included for the purposes of calculating the maximum annual percentage rate if:

- (a) the credit provider is an authorised deposit-taking institution, and
- (b) the debtor has or had an existing credit contract or debit account with the authorised deposit-taking institution at the time the temporary credit facility is or was established, and
- (c) the temporary credit facility is related to the existing credit contract or debit account.

(5) In this clause, a "temporary credit facility" includes, but is not limited to, an overdraft facility and a short term extension of the total amount of credit available under an existing credit contract.

The following regulation goes on to specify the precise formula for working out the maximum annual percentage rate.

We strongly support a similar approach to be introduced in Victoria.

It is our understanding that in New South Wales, this regulation has resulted in most expensive pay day loans being withdrawn from the market. We are aware, however, of one loophole that has developed. This involves the imposition of brokers in the transaction between consumer and the lender who will charge fees (commissions or "cheque cashing fees"). As these fees are not charged "under a credit contract", they are not included for the purposes of calculating the maximum annual percentage rate.

We note a recent amendment to the UCCC that aims to overcome a similar loophole for the purposes of determining whether the short-term credit exemption to the UCCC applies. Short-term credit (that is, the term of which is less than 62 days) which imposes charges of less than 5% of the amount of the credit is excluded from regulation under section 7 of the UCCC. The proposal aimed to capture fees and charges that may or may not be set out in the credit contract, but which must be paid to a person including a person other than the credit provider, in connection with the credit contract, for the purposes of determining that 5%. We would support a similar provision be included in any legislation that imposes a comprehensive interest rate cap to close the loophole that has developed in other jurisdictions.

Benefits of national consistency

There are a number of recent and current processes that have called on governments to transfer credit regulation to the Commonwealth government. These include

- A recommendation from the 2007 House of Representatives Standing Committee on Economics, Finance and Public Administration Inquiry into Home Loan Lending Practices and Processes; and
- The final report of the Productivity Commission's Review into Australia's Consumer Policy Framework.

Each of these reviews have outlined the benefits of national consistency, particularly as a national regime applies to other financial services and the range of deficiencies in the current state-based regime.

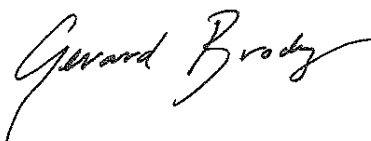
The Council of Australian Governments has also agreed in principle to the Commonwealth assuming responsibility for regulating mortgage credit and advice, including broking. A recent Green Paper from the Commonwealth Government foreshadows Commonwealth responsibility for the entire credit market. Given the increasing national character of the consumer credit market and the gaps in coverage under the state-based regime, Consumer Action supports the national regulation of consumer credit. We are providing a more detailed submission on this issue to the Green Paper which we would be happy to provide to the Inquiry.

We note that in the inter-governmental agreement that established the UCCC agreed for non-uniformity in a range of areas, including interest rate upper limits (the other areas being licensing schemes for credit providers, jurisdiction vested in specialist tribunals, and the establishment of consumer credit funds to receive civil penalty payments). It is our view that the grounds for this non-uniformity do not remain as credit regulation moves national. Consumer Action strongly believes that a comprehensive interest rate cap should be included in any moves to transfer responsibility for consumer credit regulation to the Commonwealth Government.

Should you wish to discuss this submission further, please contact us on 03 9670 5055

Yours sincerely

CONSUMER ACTION LAW CENTRE



Gerard Brody
Director – Policy & Campaigns