# The Regulation of Short Term, Small Amount Finance

Regulation Impact Statement

June 2011

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# Glossary

| Term | Definition |
|---|---|
| **ACL** | Australian credit licence |
| **ADI** | Authorised Deposit-taking Institution |
| **APR** | Annual percentage rate |
| **ASIC** | Australian Securities and Investments Commission |
| **ASIC Act** | *Australian Securities and Investments Commission Act 2001* |
| **COAG** | Council of Australian Governments |
| **Code** | National Credit Code (Schedule 1 to the *National Consumer Credit Protection Act 2009*) |
| **Credit Act** | *National Consumer Credit Protection Act 2009* |
| **EDR scheme** | External dispute resolution scheme |
| **FAA** | Financiers Association of Australia |
| **NFSF** | National Financial Services Federation |
| **RIS** | Regulation Impact Statement |
| **UCCC** | Uniform Consumer Credit Code |

# SUMMARY

One of the issues identified during the course of Phase One of the National Consumer Credit Protection reforms was the approach to be taken to short term, small amount lending ("short term lending"). This was in the context that some, but not all, States and Territories had introduced an interest rate cap. In Queensland, ACT and NSW there is currently a comprehensive cap of 48% which includes interest, fees and charges. In Victoria there is a 48% interest rate cap excluding fees and charges. There is no cap in WA, NT, SA[1] and Tasmania.

It was agreed that during Phase Two of the reforms, the need for Commonwealth intervention in relation to the cost of short term lending would be considered. As part of this, an examination would be undertaken of the role of interest rate caps. In the meantime those States and Territories who had interest rate caps would retain them.

The key findings in this Regulation Impact Statement (RIS) are as follows:

- The majority of consumers accessing short term credit have low incomes, with possibly up to 25% of borrowers having incomes below the Henderson Poverty Line ($401 a week for a single working person as at March 2010).
- Borrowers largely have no access to other forms of credit (with some surveys finding that this is the situation of over 70% of borrowers).
- The most common uses of the funds advanced under short-term loans are to meet living expenses, such as bills (including utilities), food, rent, and car repairs and registration. There is minimal or negligible use of short term loans for discretionary spending purposes.
- Research consistently demonstrates that borrowers who use short-term loans rarely select a lender on the basis of price. Factors such as the speed of provision of loan have a greater influence, and this is reflected in the advertising used by these lenders.
  - There is an element of self-selection in that consumers who are price sensitive are more likely to be deterred from using short term loans and seeking alternatives; that is, the more vulnerable the consumer the more likely they are to use short-term loans.
- The combination of low incomes and the use of loan proceeds to meet basic expenses can result in significant levels of repeat borrowing.
- There are significant variations in the level of costs charged by short-term lenders. The impact on low income borrowers (defined as those with an annual income of $24,000) of loans of between $300 and $1,000 over terms of 1 week to 1 year can be summarised as follows:

[1] The *Consumer Credit (South Australia) (Pay Day Lending) Amendment Bill* 2009 was introduced into the South Australian Legislative Council in February 2009 to implement a 48% interest rate cap, inclusive of fees and charges. The Bill was put on hold in light of the National credit reform package and related Phase Two work on interest rate caps.

  - The cost of a single loan can be between 2.59 and 50.05% of their income during the period of the loan.

  - The cost of two consecutive loans (where it is assumed the borrower uses 25% of the proceeds of the second loan to repay the first loan) can reduce the borrower's income by between 9.55 and 77.13%, during the period of the two loans.

- Consumers who use leases also are largely unable to access mainstream sources of finance, and can only acquire household goods through leases. This form of finance has a number of inherent risks including that consumers may not be able to own the goods at the end of the contract, and that consumers may therefore make significant payments relative to their income without obtaining any long-term benefit.

The level of costs that can be charged can result in consumers being unable to a continued financial exclusion, and consequent greater risk of social exclusion. The higher the costs charged the greater the impact on a consumer's income, default rates and level of social inclusion. This means that the most financially vulnerable consumers are paying high costs relative to their income when using short term, non-productive forms of finance, resulting in financial harm through an inability to accumulate savings or personal wealth, and a risk of continuing dependency on these products.

# BACKGROUND

## CHARACTERISTICS OF SHORT TERM, SMALL AMOUNT FINANCE

There is no universally accepted or comprehensive definition of short term, small amount lending. The Victorian Department of Justice undertook a Small Amount Lending Inquiry in 2008; it developed a definition of a small amount loan as one that included features based on the position of the borrower, and that did not only depend on the size or duration of the loan. The Inquiry defined a small amount loan as a loan that: is provided by a lender who typically targets consumers who have limited access to credit, including consumers with low incomes or poor credit records; offers easy and fast processing from application to approval and provision of funds; has a short term duration; has a fixed fee or charge for the loan with low or unexpressed annual interest charges[2]; and requires repayment via a direct debit authority.[3]

The National Financial Services Federation (NFSF) a peak industry body, categorises two types of short term, small amount lending as follows:[4]

- Payday loan: "a payday loan is a small short term loan, usually of two to four weeks duration, often designed to help meet unexpected expenses". This RIS uses the term

[2] The presence of a substantial fixed fee or charge would be unique to Victoria given that the cap in that State only applies to interest charges and not fees, and therefore fees will be higher while the interest rate may be lower than would be the case in other jurisdictions.
[3] Consumer Affairs Victoria, 'Small Amount Lending Inquiry 2008', Report to Tony Robinson MP, 2008, p. 5
[4] http://www.nfsf.org.au/about-microlending-pay-day-advances.htm

*'payday loan'* to refer to a loan of under $1000, and for a duration of less than three months.[5]

- Micro-loan: "a loan that has a slightly longer duration, averaging between three to twelve months, and for amounts of $500 or more". This RIS uses the term *'micro-loan'* to refer to a loan of this term but where the amount advanced is $1000 or more.

The two categories are not exhaustive, in that there are other types of credit that do not fall within these strict definitions but still may meet some of the characteristics adopted in the Victorian Department of Justice's Small Amount Lending Inquiry. In this RIS the term *'short term lending'* is used to refer to this broader definition, that would encompass both payday loans and micro-loans.

This type of lending does not include the form of credit known as *'micro-finance'*, that is, non-commercial lending that focuses on poverty alleviation or community building, where the purpose of the credit is to improve the overall financial capacity of the borrower. These loans often charge zero or low (cost covering) interest, and are typically provided through charitable organisations.

Another form of small amount finance is consumer leases. Any regulatory intervention proposed as a result of the Phase Two considerations should apply equally to consumer leases for the following reasons:

- the cost of the lease can result in similar problems to those identified in this RIS in relation to credit contracts (noting that the absence of any disclosure of the cost of leases in a comparative way, as outlined in the RIS addressing consumer leases, reduces the likelihood of consumers actively seeking cheaper forms of leases) ; and
- some transactions are structured as leases to avoid the obligations that, under the Credit Act, only apply to credit contracts (for example, where the contract is in substance a loan, as the goods being leased have only a nominal value or where the consumer 'sells' their own goods to the lessor and then leases them back).[6]

The level of research into leases is substantially less than in relation to small amount lending (and they are therefore discussed in less detail below).

## Current Regulatory Framework

### States and Territories – Current regulation

As previously mentioned, during Phase One of the credit reform process, it was agreed that States and Territories who had interest rate caps would be allowed to maintain them. The current position in respect of each State and Territory is set out in Table 1 below.

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[5] It also is consistent with the approaches taken by academics G. Marston and L. Shevellar in their report discussed below.

[6] This risk was identified in the submission to the Green Paper by the Financiers Association of Australia, p. 21.

**Table 1: Approach of each State and Territory to interest rate caps**

| Jurisdiction | Regulation |
|---|---|
| ACT | • A maximum cap of 48% per annum, inclusive of fees and charges.<br>• The ACT Government has not made an announcement about the future of its interest rate cap. |
| New South Wales | • A maximum cap of 48% per annum, inclusive of interest, fees and charges commenced in March 2006.<br>• In March 2010 NSW enacted legislation which continues, until 1 July 2011, its interest rate cap with amendments to expand the definition of credit fees and charges included in the calculation. |
| Northern Territory | • No interest rate cap. |
| Queensland | • A maximum cap of 48% per annum, inclusive of interest, fees and charges. Current arrangements commenced on 31 July 2008.<br>• Queensland has retained its interest rate cap. |
| South Australia | • No interest rate cap. However, following the release of a discussion paper in October 2006, South Australia introduced the Consumer Credit (South Australia) (Pay Day Lending) Amendment Bill 2009 which would have implemented a 48% interest rate cap, inclusive of fees and charges. This Bill lapsed in light of the Federal Phase Two work on interest rate caps. |
| Tasmania | • No interest rate cap or licensing/registration requirements.<br>• Introduced, but did not enact, legislation to restrict advertising of credit products where the total cost of credit exceeded 40% per annum. |
| Victoria | • A maximum cap of 48% per annum for unsecured credit and 30% per annum for secured credit, exclusive of fees and charges.<br>• Victoria has enacted legislation which continues its cap until 1 July 2011. |
| Western Australia | • No interest rate cap. |

## The National Consumer Credit Protection Act 2009

The *National Consumer Credit Protection Act 2009* (the Credit Act) regulates the provision of consumer credit, including most short term, small amount loans (noting that it will not

apply to forms of lending where the structure of the transaction avoids the application of the Credit Act). Under the Credit Act providers and brokers of consumer credit must be licensed, comply with responsible lending obligations, disclosure requirements and various other obligations.

The Credit Act does not directly regulate fees or interest charges. However the National Credit Code does include remedies:

- Where the contract is unjust, including because the annual percentage rate or costs are excessive (section 76) – taking into the risks undertaken by the credit provider and, if the injustice is alleged to result from excessive interest charges, the annual percentage rate or rates charged by other credit providers in comparable cases.

- Where the contract is unjust, because a fee or charge is unconscionable (section 78).

There are no recorded cases of either consumers or regulators having successfully used the Code (or equivalent provisions under the UCCC, in place since 1996) in order to have a contract declared unjust because of the annual percentage rate or the level of fees or charges.

Unconscionability must be demonstrated on a case by case basis and, where the level of costs is said to be too high, will require evidence of the credit provider's costs in the provision of a loan. Consumers generally have difficulty in obtaining access to information about the lender's real costs, making them unable to determine whether or not the provision restricting their capacity to decide whether or not to commence legal proceedings.

In 2005, Consumer Affairs Victoria argued that credit fees and charges imposed by a small amount lender, City Finance, were, across all its loans, of such an amount that they were unconscionable. The Tribunal found that this remedy depended on evidence of the relationship between the borrower and the lender, and that the amount or nature of the fee could not in itself render it unconscionable.[7] The effect of this finding is to make it uneconomic for consumers to seek a remedy under section 78.[8]

The Credit Act also introduces, for the first time, a requirement that credit providers, lessors and brokers must provide or arrange credit and consumer leases responsibly; that is, a provision of credit to a consumer must not be unsuitable having regard to their needs and requirements, and their capacity to repay the loan without substantial hardship. Responsible lending will not in itself affect the cost of these products, although it may limit access to it for particular consumers in some circumstances, where their application is denied because they cannot afford to meet the repayments under the proposed contract. This issue is discussed in more detail in the problem identification section of this RIS.

### The Australian Securities and Investments Commission Act 2001

The Australian Securities and Investments Commission Act 2001 (ASIC Act) provides, in section 12GB, that a term of a consumer contract (including a credit contract or lease) is unfair if:

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[7] *Director of Consumer Affairs v City Finance Loans (Credit)* [2005] VCAT 1989, 27.
[8] Consumer Affairs Victoria, 'The Report of the Consumer Credit Review', Supplementary Information, 2006, p. 336

- it would cause a significant imbalance in the parties' rights and obligations arising under the contract;
- it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term; and
- it would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.

Pursuant to 12BI of the ASIC Act, the unfair contract term provision does not apply to terms that define the main subject matter of the contract, or set the upfront price payable under a contract. This includes interest rates and entry fees and charges. Accordingly, it would not provide a borrower with recourse in relation to credit on the basis the cost is unfair (or therefore restrain lenders from charging higher costs because of the absence of any risk of the cost being characterised as unfair).

Other sections of the ASIC Act prohibit unconscionable conduct, misleading or deceptive conduct and false or misleading representations in relation to financial services. These provisions do not directly regulate the terms on which credit is provided, although they may provide a remedy because of the individual circumstances of a particular consumer (where, for example, they are vulnerable in a way that is taken advantage of by the lender), or where there have been misrepresentations by a lender.

## SOURCES OF DATA ON SHORT TERM LENDING

This RIS refers to data and analysis from a number of academic papers, reviews and submissions from both Australia and overseas. The table below sets out those papers which include primary research on the Australian market in reverse chronological order. Where relevant, information about methodology is detailed. Other papers containing secondary analysis and theoretical content are referenced in footnotes throughout this RIS.

**Table 2: Primary research papers on short term lending**

| Name | Methodology / Comments |
|---|---|
| G Marston and L Shevellar, 'The Experience of Using Fringe Lenders in Queensland: A Pilot Study', July 2010 | • 47 micro-lenders identified by NFSF sent surveys. Thirteen responses received.<br>• 44 borrowers surveyed in total (28 surveyed in-depth). Borrowers self-selected by responding to a request contained in a postcard that was available at loan centres, financial counsellors and offices of legal aid.<br>• Interviews with ten other stakeholders including: two government officials, one academic, three financial counsellors, three consumer advocates and one representative from a community finance institution. |
| National Australia Bank, | • Pilot project related to loans of $1000 - $5000 of a term |

| | |
|---|---|
| 'Do you really want to hurt me: Exploring the costs of fringe lending - A report on the NAB small loans pilot', 2010. | of 12 months.<br>• 510 loans were written. 328 clients were contacted for survey and 64 responses were received. Out of a possible 4664 non clients (those who were refused), 40 responses were received. |
| Z Gillam and Consumer Action Law Centre, 'Payday Loans, Helping Hand or Quicksand', 2010 | • Online survey of 448 borrowers (of loans under $2000 to be repaid in less than eight weeks).<br>• Qualitative research involving four group discussions, five standard depth interviews, and three in-home interviews. |
| A Ellison and R Forster, Policis, 'The dynamics of low income credit use', undated[9] | • Three focus groups of unknown size.<br>• Telephone survey across Adelaide, Brisbane Melbourne, Perth and Sydney. Sample of 500 low income consumers; 400 low income credit users; 320 low income users of payday loans. |
| N Howell, T Wilson, J Davidson for Consumer Credit Legal Centre 'Interest Rate Caps, Protection or Paternalism, December 2008 | • Survey of 40 short term lending businesses in Queensland. Business chosen from telephone book and names provided by NFSF. Information requested in relation to $1000 loans and $300 loans.<br>• In addition 20 qualitative interviews with nine consumer advocates in QLD, NSW, VIC, Act; five micro-lenders in QLD, NSW; six government staff from QLD, NSW, VIC; seven representatives from five mainstream lenders. |
| R Scutella and G Sheehan Brotherhood of St Laurence, 'To their Credit. Evaluating an experiment with personal loans for people on low incomes', 2006. | • Six focus groups of 33 people in Victoria. |
| Market Intelligence Strategy Centre (MISC) Australia for Consumer | • Compilation of database of 277 micro-loan products available in Victoria (information acquired via stakeholder contracts, lenders directly, website checks, |

[9] Neil Ashton for Consumer Action Legal Centre (CALC), in a Draft Payday Lending Literature Review, states that the research underpinning these papers was commissioned by Cash Converters, although this has not been disclosed in the paper. CALC states that ..."after investigation, an email inquiry to Policis was answered by report author Anna Ellison who confirmed that the report was prepared by Policis in 2008 (see email from Anna Ellison to Consumer Action Law Centre, 21 May 2008). Although Policis would not reveal for whom the report was commissioned, an email from 18 May 2008 from Glenn Donaldson of Cash Converters revealed that the report had been commissioned by Cash Converters", p. 19.

| | |
|---|---|
| Affairs Victoria, 'Consumer Credit Report', 2006. | mystery shopping and loan enquiries over the phone). |
| D Wilson, Consumer Law Centre Victoria, 'Payday Lending in Victoria – A research report', 2002 | • Interviews with 10 financial counsellors and consumer support workers in Victoria.<br>• Telephone survey of 20 businesses (of which data was collected for 18).<br>• A Street survey of 78 consumers (with 72 being consumers applying for or repaying payday loans) taken in the vicinity of payday lenders in 11 locations across Victoria.<br>• 12 in-depth interviews (11 were volunteers from the street survey, 1 was referred from a financial counsellor). |

In a 2010 study and literature review on the short term lending industry the academics Gregory Marston and Lynda Shevellar note that much of the existing research on the topic in Australia and around the world is heavily biased – "even seemingly objective academic research projects are often sponsored by a consumer advocacy organisation, a bank, or the non-bank lending industry"[10]... "all...positions are validated and denied, proven and disproven, argued for and rallied against'.[11]

This RIS also refers to overseas experiences with short term credit, noting that differences in regulatory approaches, product design and practical operation may limit their relevance.

## FINANCIAL POSITION OF CONSUMERS WHO USE SHORT TERM CREDIT

### Income Levels

Studies of short term credit have consistently found that borrowers on very low incomes constitute a significant percentage of the people who use short term loans:

- Dean Wilson's 2002 study found that 43% of payday borrowers earned less than $20,852 per annum[12] and 85% of borrowers earned below $31,304 per annum. Overall 44% of payday consumers had dependent children and 80% lived in rental accommodation.[13]

[10] G Marston and L Shevellar, University of Queensland, 'The Experience of Using Fringe Lenders in Queensland: A Pilot Study' 2010, p. 9
[11] Marston and Shevellar, p. 9
[12] Wilson, p. 57
[13] Wilson, p. 59.

- In the recent Marston and Shevellar pilot study of the Queensland short term lending market borrowers in Queensland, the authors state that "the overwhelming majority of the borrowers we spoke with were living below widely accepted measures of poverty. A quarter of the borrowers we spoke with were routinely accessing emergency relief for food vouchers".[14] Of the 44 borrowers interviewed, only six had full-time employment.[15]
- The 2010 Consumer Action Legal Centre Report[16] found that 28.1% of respondents were in part-time or casual employment and 21.9% unemployed. For those consumers who were employed, 72.8% had income levels below the average wage. 23.4% had incomes of less than $20,000.[17]
- Policis reports that half of the payday customers it surveyed for its Australian paper "The Dynamics of Low Income Credit Use" had household incomes of below $35,000.[18]
- Data provided by Cash Stop (quoting uncited research of over 122 lending outlets and 4000 borrowers by Smiles Turner for the NFSF in 2006) found that 50.1% of applicants received social security payments (including where this was their only income).[19]
- The Wesley Community Legal Service noted in its 2010 Green Paper Submission that in its experience short term loans are used by vulnerable classes of consumers, including indigenous people, people with disabilities, people with gambling problems, and those with little education and very low financial literacy. National Legal Aid stated that the majority of consumers who came to legal aid in relation to these loans were Centrelink recipients or low income workers.[20]
- 2010 Cash Converters data shows that 46.15% of borrowers of loans of less than $1000 and of one month duration (Cash Advance Loans) received government benefits (although they may also be in receipt of other income).[21] The figure was 43.93% for borrowers of their other main product (a Personal Loan), a loan over $1000 with a duration of 6 – 12 months. Table 3 below sets out the income level of borrowers for each type of loan, and shows that for Cash Advance loans, 75.69% of customers have an income of under $36,000 and just under half had an income of under $24,000.[22]

**Table 3: Income levels of borrowers taking out Cash Converter's Cash Advance and Personal Loan products**

| Net Income (pa after tax) | Cash Advance | Personal Loans |
|---|---|---|
| $0-$11,999 | 14.76% | 8.93% |
| $12,000 - $23,999 | 34.19% | 34.66% |

[14] Marston and Shevellar, p. 6
[15] Marston and Shevellar, p. 5
[16] CALC noted that because the study was undertaken online, some of the most vulnerable may have been excluded, and therefore there may have been some distortion in results. Gillam, p. 54
[17] Gillam, p. 53
[18] Policis, 'The Dynamics of Low Income Credit Use', undated, p. 29
[19] Cash Stop Financial Services, 'Response to the National Credit Reform Green Paper', 2010, p. 10
[20] National Legal Aid, 'Green Paper on National Credit Reform, NLA Response', 2010, p.23
[21] Cash Converters 2010, p. 7
[22] Cash Converters 2010, p. 6

| | | |
|---|---|---|
| \$24,000 - \$35,999 | 26.74% | 32.63% |
| \$36,000 - \$47,999 | 15.36% | 15.52% |
| \$48,000 - \$59,999 | 4.96% | 4.78% |
| \$60,000 - \$71,999 | 1.95% | 1.85% |
| \$72,000 - \$83,999 | 1.00% | 0.82% |
| \$84,000 + | 1.04% | 0.82% |

These studies show consistency between the reporting of income levels of short term borrowers. In summary the data suggests that:

- Approximately 40 to 49% of short term customers have an annual income of less than \$24,000.
- Between 50 to 74% of short term customers have an annual income of less than \$36,000.
- 50% of short term customers are partially employed or unemployed.
- Between 46 and 50% of short term customers are in receipt of government benefits.

The research also demonstrates that a substantial number of short term borrowers, possibly up to 25%, have incomes that are so low that they fall beneath the Henderson Poverty Line. This is a measure of the minimum income level needed to avoid a situation of poverty, and varies according to whether or not a person is working and the number of dependants.[23] The March 2010 Poverty Line figures assessed a working single person with an after-tax income of under \$401 a week (\$20,852 pa) to be in poverty; and a non-working single person with a disposable income of under \$325 a week (\$16,900 pa) to be in poverty.[24] These figures assume no children – a person who has dependents would require a higher income to be above the Poverty Line.

In 2010, 14.76% of Cash Converters payday customers had incomes of under \$12,000 per annum, and were therefore below the Poverty Line. A further 34.19% of their customers had incomes of between \$12,000 and \$24,000, a portion of whom would also fall below the Poverty Line. These figures are consistent with those in Wilson's 2002 study, which found that 43% of payday borrowers earned less than \$20,852 per annum and 38% were below the Henderson Poverty Line.[25] The 2010 CALC report showed 23.4% of surveyed consumers had incomes of less than \$20,000 and were therefore just on or below the Poverty Line.

These figures are consistent with the US experience of short term lending (notwithstanding differences in product structure in that country that mean the poorest consumers tend to be

[23] Published by Melbourne Institute of Applied Economic and Social Research, University of Melbourne
[24] Income is required to meet the cost of housing. Note that the level varies according to family type and circumstances (for example, according to the number of children or employment status).
[25] Wilson, p. 57.

excluded from the short term credit market).[26] The American Federal Reserve Board undertakes a tri-annual Survey of Consumer Finances.[27] In 2007 the mean income of families who took out a payday loan was $32,614 (the median was $30,892), contrasted to a mean income of $85,473 (median was $48,397) for those who did not use a payday loan.[28] Families who had borrowed from payday lenders had a mean net worth of $22,616 (and, remarkably, had a median net worth of $0). Those who did not use payday lenders had a mean net worth more than 20 times that – $469,374 (median $80,510).[29] 41% of families borrowing from a payday lender were headed by single women, and 40% were headed by married couples.[30]

### Lack of access to alternative sources of credit

The Australian research demonstrates that many consumers use small amount lenders because they are unable to access alternative forms of credit:

- In its submission Cash Stop quotes research undertaken by Smiles Turner for the NFSF of 3408 consumers across Australia. Cash Stop states that the research demonstrated that a large proportion of consumers reported that they had no access to other forms of credit – 71.6% (QLD), 72.1% (SA), 76.7% (NSW); 81.6% WA.[31]

- The submission by the Financiers Association of Australia and Minit-Software to the Green Paper[32] lists poor credit history as one of the reasons consumers access short term loans.[33]

- Cash Converters report that 3 in 10 of their clients cannot get credit from other types of lenders.[34]

- Consumers surveyed in the Marston and Shevellar Pilot Study also reported that they felt they had little choice but to access high cost credit.[35]

There is qualitative evidence that the inability to access alternative credit, and the consequent need to obtain a short term loan, is perceived by some borrowers as a personal failure because of an inability to manage their finances.[36] Analysis of qualitative interviews

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[26] In America a consumer often borrows by receiving an amount to be repaid either by cash, or, should this not occur, by the lender presenting a post-dated cheque. Borrowers are therefore required to have a cheque account, and, as many lower income households in the USA do not have checking accounts this prevents them from obtaining payday loans (and results in them using alternative sources of finance, such as pawnbrokers).See E Lawrence and G Ellihausen, 'A Comparative Analysis of Payday Loan Customers,' Contemporary Economic Policy, Vol 26, No. 2, 2008, p. 305.

[27] The survey includes a random sample of approximately 4400 families, and is widely used by government and economic research centres.

[28] A. Logan and C. Weller for Centre for American Progress, 'Who Borrows From Payday Lenders? An Analysis of Newly Available Data', 2009, p. 7

[29] Logan and Weller, p. 8 - 9

[30] Logan and Weller, p. 6

[31] Smiles Turner is registered on the WA register of lobbyists on behalf of Cash Stop.

[32] Min-it Software produces in-house software specifically for payday and micro-lenders.

[33] Min-it Software and Financiers Association of Australia, 'Submission, Green Paper, National Credit Reform, 2010, p. 11. Additional factors are being new to a country or area, disenchantment with mainstream lenders, and locality.

[34] Cash Converters, 2010, Appendix Two

[35] Marston and Shevellar, p. 6

[36] Gillam, pp. 64 and 231.

indicates that some borrowers felt that their need to use these types of loans was shameful or embarrassing, and as something that would be concealed from friends and family.

## CONSUMER NEEDS MET THROUGH USE OF SHORT TERM CREDIT

The data below demonstrates, across a range of sources, that approximately 70% of loans are used by consumers to meet recurrent or basic living expenses:

- The 2010 CALC paper reported that 71.3% of surveyed consumers used short term loans to pay for basic expenses: utility bills (21%), food (17.6%) and rent (10.7%).[37] 22% of the loans were used to pay for car repairs or registration.
- The 2002 Wilson paper reported that respondents had taken out short term loans to pay for bills (32%), day to day living expenses (26%), car repairs or registration (10%), and rent or mortgage (10%). In total 78% of borrowers were borrowing for non-discretionary spending.[38]
- Research by the Policis research consultancy found that credit, particularly small sum credit, is used by low income households primarily for essentials and to ensure the effective functioning of household finances. Policis described 28% of borrowing as "distress borrowing" to deal with cash shortfalls; 29% was used to meet unexpected bills and expenses; and 9% was used to meet regular bills and expenses. Credit was used to finance spending on discretionary items in only 10% of cases.[39]
- Data provided by Cash Converters in a 2008 submission to Treasury is consistent with these findings, showing that nearly 6 in 10 of their clients with incomes less than $35,000 per annum would be unable to manage a cash emergency without borrowing and 55% would be unable to renew or repair essential equipment.[40] This suggests that its clients are borrowing to meet emergencies of this type.
- Data provided by Cash Stop, quoting Smiles Turner research, found that the top uses for credit were for basic expenses and bills (29.8%), personal (32.9%), car expenses (8.1%) and groceries (5.6%). A similar SA study undertaken by Smiles Turner in 2007 of 533 South Australian consumers had similar findings: bills (25.3%); groceries and food (22%); shopping (undefined) (16.1%); living costs (11.2%); and car repairs / maintenance (10%).[41]

In summary, between 50 and 70% of short term borrowers primarily use short term credit to meet basic living expenses, presumably because of their low incomes.
In addition to the above uses, Australian data also suggests that short term loans are used by problem gamblers when they have exhausted other alternative sources of funds (for example, accessing available money in transaction or home loan accounts, or on a credit card).[42] The extent of this use has not been quantified, although the South Australian Centre for Economic Studies in a 2010 paper quoted data suggested that 8% of problem gamblers had obtained funds from short term lenders.[43] The Honourable Ann Bressington, Member of

[37] Gillam, p. 59
[38] Wilson, p. 36
[39] Policis, p. 8
[40] Cash Converters, 'Position Paper, Response to the Federal Government's Green Paper on Financial Services and Credit Reform, 2008', p. 10
[41] Cash Stop Financial Services, p. 11
[42] South Australian Centre for Economic Studies, 2010, p. 38
[43] South Australian Centre for Economic Studies, 2010, p. 33 - 34

the South Australian Legislative Council referred to this issue during her reading speech for the *Consumer Credit (South Australia)(Pay Day Lending) Amendment Bill*. She said: "there are about 20 payday lenders operating in Adelaide, and just about all of them are located in lower socioeconomic areas in the north and south. Many are located within close proximity to gambling facilities, and social welfare groups have advised my office that they have heard many reports of people using these loans to gamble or buy drugs and alcohol."[44]

Again, the Australian research as to the use of funds provided by short term lenders is consistent with that undertaken in the United Kingdom and the United States.

In the United Kingdom research by Paul Jones from the University of Liverpool found that over 90% of participants needed to obtain credit to make ends meet. The interviews and focus groups identified how people regularly borrowed to pay bills, to buy clothes and school uniforms, and for birthdays, holidays and Christmas.[45] Berthoud and Kempson found that "poorer families, on the whole, use credit to ease financial difficulties and those who are better-off take on credit commitments to finance a consumer life-style".[46]

The American Survey of Consumer Finances found that 29% of borrowers gave their reason for borrowing as an emergency, 21% cited a basic consumption need, 8% stated that it was the only option available to them, while 34% borrowed for convenience.[47]

## Reliance by consumers on Short term Small amount Credit

The Australian research demonstrates that many low-income consumers use small amount lenders because they have an urgent need for finance, and because they are unable to access alternative forms of credit. The combination of these factors means that:

- Consumers tend not to identify different short term lenders and consciously choose between them, as, presumably, they are keen to obtain finance as quickly as possible from the first available lender.
- Consumers are generally not price sensitive, as the inability to access alternative sources of finance and the financial pressure they may be experiencing result in them accepting the credit irrespective of the terms on which it is offered. As noted above, consumers who use short-term lenders can feel a sense of failure, and this in turn can make them grateful to a lender who they perceive as helping them when no one else would. [48]

The following research demonstrates these trends:

- The Consumer Action Legal Centre's 2008 survey found that less than one third of respondents who had accessed short term loans from a particular lender knew of other companies providing similar loans.[49]

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[44] South Australian Legislative Council Reading Speech, Consumer Credit (South Australia) (Payday Lending) Amendment Bill, 8 April 2009, p. 1936

[45] P. Jones, 'Access to Credit on a Low Income: A study into how people on low incomes in Liverpool access and use consumer credit', p. 9

[46] R. Berthoud and E. Kempson, 'Credit and Debt: The PSI Report', Policy Studies Institute: London. 1992, quoted in Wilson, p. 36

[47] Logan and Weller, p. 11

[48] Gillam, pp. 73-4.

[49] Gillam, p. 221

- A current supplier of software programs to a large number of payday lenders has advised that less than 5% of consumers appear on the database of more than one lender. [50] Consumers surveyed by Policis[51] (and later quoted by Cash Converters in its submission) stated that their primary motivations to access short term credit were:
  - Quick access to cash when you need it (just over 80%)
  - Minimum hassle forms and process (just under 50%)
  - Can borrow small sums difficult to get from bank (just over 50%)
  - Can pay back over short term (just over 60%)
  - Banks less flexible or accessible (approximately 45%)
- Wilson observes that, for the twelve customers with whom he undertook in-depth interviews, a high standard of personalised customer service was a common experience. Karen Sampford notes that the market is characterised by strong brand loyalty, and that this can equate to a failure to compare products of different providers.[52]
- The 2008 CALC survey had some findings in relation to cost that demonstrated that consumers were not just insensitive to price, but ignorant of it:
  - 12.9% of respondents stated that the amount that they were charged for the loan by the lender was $0, and a further 8.9% of respondents stated that the amount that they were charged for the loan by the lender was either $10 or $20 (when the amount would have been closer to $100). [53]

Less than 10% of borrowers choose short term lenders because of cost. Only 4.9% of consumers surveyed chose their short term loan due to low fees; and only 4.5% because of good rates.[54] advertising for short term loans in Australia is consistent with this research in that it rarely includes references to the cost of these products, with marketing focusing on other features such as speed, accessibility, lack of credit checks (as noted by the Griffith University research).

These findings are also consistent with those from the 2010 UK Review on High Cost Credit which found that consumers who take out short term loans are often unaware of other options, and tend to focus on how quickly and easily the product can be accessed, and how affordable the product is, rather than focusing on cost.[55] The UK Competition Commission investigated the cost of consumer credit in that country and said "we found it striking that there was so little evidence of price competition of any kind; not only no lowering of headline prices, but no differentiation of prices, discounting or offering higher rebates… as a means of keeping customers who might defect or attracting new ones".[56] American researchers similarly note that "competition does not appear to affect fees charged [on

[50] Submission to the Green Paper by the Financiers Association of Australia, p. 11.
[51] Policis, p. 25
[52] Sampford, 13
[53] Gillam, p. 65
[54] Gillam, p. 66
[55] Office of Fair Trading Britain, 'Review of High Cost Credit, Final Report', 2010, p. 29. See also Consumer Focus, 9: "Some consumers are positively choosing this form of credit as a result of deficiencies in the mainstream: They see payday loan fees as clearer ... they feel more able to 'control' their debt ...and other forms of finance are often not considered or seen as an option because they were not available to these consumers or negative associations, such as the potential for longer-term debt."
[56] Competition Commission Britain, Home Credit Market Inquiry, Provisional Findings Report at 7.17.

payday loans] in the way one normally thinks that competition will affect loan market interest rates."[57]

Research by Drysdale and Keest in America has also suggested that consumers had little knowledge of the alternatives to payday loans.[58] A survey undertaken for the Canadian Payday Loan Association involving 350 consumer interviews similarly found that over half the consumers chose payday loans because they were quick and easy.[59]

## REPEAT BORROWING

In this section of the RIS, *'repeat borrowing'* is used to describe the following range of situations:

- A 'rollover' loan. This includes scenarios where the term of an existing loan is extended, with a borrower typically being charged additional fees and ongoing interest charges, and where a new loan is advanced which is used to repay an existing loan.
- A new loan with the same lender is taken out immediately or very soon after a previous loan has been repaid.
- A consumer who has multiple loans at the same time from different lenders.
- A consumer who regularly takes out short term loans.

In all of these situations ongoing borrowing may be required because the consumer either cannot repay the initial loan, or has only been able to do so by temporarily deferring other expenses but then requires more money to meet these deferred costs.

It is considered that there is an inherent in short term lending in respect of consumers who are on fixed incomes and who use the funds advanced to them for living expenses that their first loan will not be their last:

- Financial counsellors who provide qualitative date based on their experience in dealing with numerous consumers have reported that borrowers using short term loans experience great difficulty in avoiding repeat use.[60]

- Similarly, Wilson has reported that consumers are not easily able to avoid repeat use, and the cost of the loans, over time, can be absorbed into week-to-week budgets (with a consequent reduction in disposable income).[61]

Repeated use of these products can therefore lead to a debt spiral in which the consumer borrows repeatedly to meet their escalating cost of debt, but finds an increasing percentage of their income is used to meet the repayments on these loans, reducing their capacity to meet living expenses directly from their income.[62]

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[57] M. Flannery and L Samolyk, 'Payday Lending: Do the Costs Justify the Price?' Federal Deposit Insurance Corporation, Working Paper No. 2005-09 in Ashton, p.10
[58] Drysdale and Keest, p. 630-1
[59] Thinkwell Research, for the Canadian Payday Loan Association 'Payday Loan Customer Study: Final Report', 2010, p. 9.
[60] Gillam, p.72.
[61] Wilson, p. 75.
[62] Gillam, p. 26

Different definitions and understandings of repeat borrowing mean that it is difficult to accurately estimate the extent of repeat borrowing either in general or the particular forms of repeat borrowing mentioned above. [63] It is also the case that some borrowers may understate the amount of repeat borrowing they engage in, given that the greater the extent to which this occurs the more they may be embarrassed by this conduct reflecting adversely on their capacity to manage their finances.[64]

Australian data suggests a reasonable percentage of users of short term lending would engage in repeat borrowing:

- The 2002 Wilson paper found that in Victoria the average number of loans taken out by consumers was six per annum. 37% of consumer had used five or more short term loans in the 12 months preceding the study. 15% of the surveyed borrowers took out more than ten loans per annum.[65]
- The CALC report's findings show less evidence of repeat borrowing, with the survey finding that 27.5% of borrowers had taken two loans in the preceding 18 months. A further 8.9% had taken out three loans and 3.6% had taken out four. Cumulatively, 86.4% of respondents had taken out four or less high-cost short term loans over an eighteen month period.[66]
- The Policis report finds that payday customers in Australia take out, on average, a little over four loans per year, rising to 5 loans per year for those who believe they do not have other credit options.[67] They make repayments, on average, for 18 weeks per annum.
- 25% of the consumers interviewed by Marston and Shevellar in 2010, stated that they were 'hooked' in the short-term lending cycle.[68]

The greater the extent of repeat borrowing (including consecutive loans) the greater the probability the borrower will be left with a significant shortfall in income, depending on the terms of their loan, to meet other recurring essential costs, such as food, utilities and transport costs. The inability to stagger payments according to necessity may add to, or not resolve, the borrower's financial situation with consequent pressure on the consumer to borrow again to meet these costs, and, as noted above, to have an ongoing reduction in income as their budget now incurs the costs associated with short term lending on a continuing basis.

American data provides more detailed findings in relation to the level of repeat borrowing. In Florida and Oklahoma customers are allowed to have only one payday loan at a time. To enforce this regulation, the states maintain central databases run by a private company,[69] Veritec, in which short term lenders must register customers. This data provides useful

[63] Note that some datasets will hide repeat borrowing because a consumer can take out a new loan rather than "rolling over" an old loan, may use multiple lenders for multiple loans or a new lender to pay out a loan from an existing lender.

[64] Gillam, p. 264.

[65] Wilson, p. 65

[66] Gillam, p. 69. As previously mentioned in relation to the CALC survey, concerns have been expressed the results were skewed by the online format of the survey (ensuring that responses only come from people with internet access and capabilities).

[67] Policis, p. 41

[68] Marston and Shevellar, p. 6

[69] J. Caskey, for Federal Reserve Bank of Philadelphia, 'Payday Lending: New Research and the Big Question', Working Paper NO. 10-32, 2010, p. 4

neutral insight into the level of borrowing in these States. In Florida and Oklahoma the average number of loans over 12 months (June 2008 – May 2009) was 8.4 and 9.3 respectively. Approximately 30% of borrowers in both states took out 12 or more loans in that period.[70] These numbers are confirmed by a further study by the US Federal Deposit Insurance Corporation,[71] which found that more than a 25% of customers obtain more than 12 payday advances per annum and that more than 50% of payday loan customers take out seven or more loans per year.[72]

United States research has also identified a correlation between payday lending and bankruptcy, stating that findings "are consistent with the interpretation that payday loan applicants are financially stressed; first-time loan approval precedes significant additional high interest rate borrowing; and the consequent interest burden tips households into bankruptcy".[73]

## Characteristics of Short term Small Amount Lending

### Size and nature of the Australian market

There is limited data about the actual size of the short term lending market in Australia and researchers have noted the difficulty in obtaining reliable figures.[74] In 2006 the Market Intelligence Strategy Centre (MISC) undertook an analysis of the consumer credit market for Consumer Affairs Victoria. It noted "payday lending data provides the worst example of inconsistency, with national estimates varying from $38 million to $200 million".[75] Cash Converters also recently reported that the exact size of the short term lending market has not been quantified.[76]

According to the NFSF, in 2008 payday lending and micro loan advances constituted approximately $500 million worth of loans per annum in Australia.[77] A survey undertaken by Consumer Action Legal Centre in 2008 identified about 28 large short term lenders operating in Australia at that time.[78] The more current data below demonstrates that there are a large number of providers, including Cash Converters and international entities like the Cash Store, that expect to expand at a rapid rate. Cash Convertors alone currently accounts for just under $257 million worth of short terms loans per annum. A smaller operation – Money3 – has nine branches and revenue in 2010 of $11,000,772. It would appear that there has been a significant increase in the size of the market since the NFSF estimated it at $500 million in 2008.

[70] J Caskey, p. 5
[71] M. Flannery and K. Samolyk, 'Payday Lending: Do the Costs Justify the Price?', Federal Deposit Insurance Corporation, Working Paper No. 2005-09, p. 2.
[72] Flannery and Samolyk, p. 5
[73] Skiba and Tobacman, p. 23
[74] Market Intelligence Strategy Centre (MISC) Australia for Consumer Affairs Victoria, 'Consumer Credit Report', 2006, p. 51
[75] MISC, p. 51
[76] Cash Converters, 'Response to the Commonwealth Government Green Paper on Consumer Credit Reform - Phase 2' , 2010, p. 5
[77] National Financial Service Federation, 'Submission to Financial Services and Credit Reform Green Paper', 2008, p. 2
[78] Z. Gillam and Consumer Action Law Centre, 'Payday Loans, Helping Hand or Quicksand', 2010, p. 10

There are currently at least 567 branches of short term providers in Australia. This number is an indicative minimum only. It tallies the number, as disclosed on each provider's website, of branches and franchises of well-known short term loan providers (as listed below). There are providers who are lesser known or who have a small number of branches that have not been included in this calculation.

There are two industry bodies that represent short-term lenders, the National Financial Services Federation (NFSF) and the Financiers Association of Australia (FAA). Both bodies have approximately 75 members (that is, counting franchise arrangements as a single member). Some lenders are members of both bodies, and between them they represent approximately half of all short-term lenders.

### Market distribution

The two main distribution channels for short term loans are at a storefront or online. Many businesses offer both avenues. It is understood that there are six major storefront short term lenders in the Australian market – Cash Converters, the Cash Store, Cash Stop, Fast Access Finance, Cash Doctors and City Finance. In addition to these are a number of smaller lenders, who may have numerous retail outlets. A review of internet-only short term loan providers undertaken by CALC in 2010 identified more than twenty.[79] However, according to the CALC survey of 448 consumers in 2008, only a small percentage of borrowing was done purely online.[80]

A number of providers of short term lending services categorise themselves as “brokers”, by organising loans from a third party. However, these models are different from mainstream broking in that generally the broker only arranges short term or small amount loans, rather than a broader range of products. In practice, the role of the broker may be limited to acting as an intermediary rather than being involved in product selection, thereby allowing an additional fee to be charged, and avoiding the restrictions on fees charged by the lender in the jurisdictions where a cap applies.

### Expansion rates

The short term, small amount lending market is currently expanding rather than contracting. The researcher Dean Wilson identified the following factors as contributing to this increase: "deregulation of the mainstream financial services and withdrawal of services from low-income consumers; stagnating or declining real incomes amongst lower income earners in industrialised economies; rising levels of credit use across social strata; increasing levels of household debt and declining levels of savings; and rising rates of personal bankruptcy.”[81]

It is noted that in America the short term market has grown rapidly. In the early 1990s this number was put at 200 payday lending stores in the country. The number had grown to 25,000 by 2007[82] with “payday lenders... having more storefronts than McDonald’s and Starbucks combined”.[83] A similar growth has been experienced in the United Kingdom. The 2010 report *Keeping the Plates Spinning* by the British statutory body, Consumer Focus, stated

[79] Gillam, p. 11
[80] Gillam, p. 90
[81] D. Wilson for Consumer Law Centre Victoria, 'Payday Lending in Victoria – A research report', 2002, p. 29
[82] Gillam, p.124
[83] P. Skiba and J. Tobacman, ‘Do Payday Loans Cause Bankruptcy’, 2009, p. 2

that the number of people using high cost short term credit in England had quadrupled over the preceding 4 years to 1.2 million people (borrowing a combined total £1.2 billion). This research also estimated that the number of these loans had from 1.2 million in 2006 to 4.1 million in 2010.[84]

### Major providers of short term loans

There are a number of major short term lenders in Australia, as follows:

- Cash Converters is the largest short term lender in Australia. It is a public company that in August 2010 had 137 outlets, and employed more than 2000 staff Australia-wide.[85]
  - In the 2009 – 2010 financial year it provided 626,555 short term loans, amounting to $256,947,297 in transaction value.[86] The predominant area of Cash Converters business falls into what the company describes as cash advance loans. These are loans of less than $1000 and of one month duration. In the 2009 – 2010 financial year, 90.29% of Cash Converters' short term lending business fell into this category. The rest of the loans are categorised by the company as personal loans, are over $1000 and have a duration of 6 – 12 months.[87]
  - In the six months to December 2010 Cash Converters reported a 48 percent growth in revenue and a net profit of 14.3 million. Cash Converters reported that one reason for the growth was the implementation of an online loan application system; from 5,868 online enquiries, 1,823 loans, totalling $2.5 million were written with 82% of the borrowers being new customers.[88]
- The Cash Store Australia Holdings Inc. ("the Cash Store") is another large provider of short term loan services in Australia. By the end of the 2010 financial year, it operated 61 branches in Australia (doubling the number of branches over that year):
  - In most states, the company acts as a broker on behalf of consumers seeking short term advances from third party lenders.[89] The Cash Store reports that the average type of loan it provides is a loan of $400 with a term of less than 31 days. It charges a brokerage fee of $30 per $100 advanced. The consumer will additionally pay 48% interest to a third party lender.
- City Finance has 114 franchised locations across Australia, and expects to open another 22 franchises in the near future.[90] Some businesses are run from the franchisee's home.
- Cash Doctors has branches in at least 79 towns across Australia.
- Cash Stop has 42 branches across Australia.
- Fast Access Finance has 32 branches across Queensland.

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[84] Consumer Focus, 'Keeping the Plates Spinning: Perceptions of Payday Loans in Britain', 2010, p. 12
[85] Cash Convertors 2010, p. 3
[86] Cash Converters 2010, p. 5
[87] Cash Converters 2010, p. 5
[88] Cash Converters International Limited, Financial Report Half-Year End December 31 2010.
[89] The Cash Store Australia, p. 6
[90] http://www.cityfinance.com.au/franchise-news

- Cash Loan Money Centre has 29 branches across NSW, QLD, VIC, TAS and WA.
- Money3 is a publicly listed company with 9 branches across Victoria. In the financial year 2010 it had revenue of $11,000,772 and a profit of $3,114,739.[91]

### Costs charged by Short Term Lenders

Reviews of short term lending have identified a significant divergence in the level of costs charged by different lenders. Table 4 sets out a comprehensive analysis of costs of short term loans charged by 40 Queensland lenders (undertaken by Howell in 2008). It sets out, for different products, the range of interest rates charged, and the costs to the borrower (set out as the total amount they repaid, expressed as a percentage of the principal).

**Table 4: Griffith University Review: Ranges of APRs and total payments as a percentage of principal**

| Product type | Principal ($) | Duration (weeks) | APR[92] all inclusive | Total payments as% of principal |
|---|---|---|---|---|
| Payday | 300 | 1 | 390-3380 | 110-165 |
| | 300 | 2-8 | 300-700 | 120-138 |
| | 1000 | 1-8 | 300-1100 | 107-133 |
| Small loan | 300 | 12-52 | 120-580 | 134 – 295 |
| Large loan | 1000 | 26-52 | 107-420 | 133 – 307 |

Table 5 sets out the cost to the consumer in dollar terms (including both fees and interest) between the lowest and highest charges for particular type of loans, and also expresses the difference between these two figures as a percentage. [93]

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[91] Money 3, 'Report to AGM' 2010, http://www.asx.com.au/asxpdf/20101112/pdf/31tvmpnvw0bbt6.pdf

[92] National Credit Code, Section 17 requires that a credit contract must specify the annual percentage rate (APR) that is used to calculate the interest payable under that contract. As it is the rate that is required to be disclosed it is most often the rate that is used to compare costs of different loan products. It has limitations in the context of short term loans, with industry participants arguing that it has the potential to be misleading. Other methods of calculating charges include calculating the total charge as a percentage of the amount lent, or simply providing the cost in dollar terms. The analysis of costs uses a mixture of these approaches (largely because it is reliant on the calculation methodologies used in the research that it references).

[93] Data extracted from Howell, p. 41- 48.

**Table 5: Griffith University Review: Range of Dollar Charges**

| Loan amount | Duration (weeks) | Lowest $ Charge | Highest $ Charge | Dollar difference between charges | % difference between dollar charges |
|---|---|---|---|---|---|
| $300 | 1 | 41.58 | 195.00 | 153.42 | 368.98% |
| $300 | 4 | 50.68 | 113.72 | 63.04 | 124.39% |
| $300 | 26 | 157.00 | 376.00 | 219.00 | 139.49% |
| $1000 | 1 | 68.15 | 231.01 | 162.86 | 238% |
| $1000 | 4 | 151.64 | 254.52 | 102.88 | 67.84% |
| $1000 | 26 | 326.00 | 1477.00 | 1151 | 353.07% |
| $1000 | 36 | 533.60 | 811.32 | 277.72 | 52% |
| $1000 | 52 | 622.68 | 2074.76 | 1452.08 | 233.2% |

The differences in cost are considerable; for example, for a loan of $1,000 over a year the difference in cost was $1452.08. It can be assumed that the lenders charging the lowest amounts above are still making a profit. However, it is not possible to determine whether the lenders charging higher costs do so because they are making substantially higher profits on individual transactions or operating business models that are relatively inefficient by comparison with other lenders.

The findings in the other reports that have analysed the range of costs charged by short-term lenders in detail are:

- The 2010 Consumer Action Legal Centre report includes a summary of charges and a calculation of APRs from a number of short term lenders.[94] The APRs calculated by CALC on loans with a 14 day term ranged from 651.7% to 886.4%, and the APRs calculated on loans with a 30 day term ranged from 304% to 413.6% (in both cases reflecting a difference in costs of approximately 25% between the cheapest and the most expensive credit).

- The 2006 MISC report stated that across Victoria "the average cost of borrowing $200 through a payday loan or chattel loan product is $54, for any single loan term... In Metropolitan Melbourne, this figure equates to $52 for any single loan term, while it is

[94] Gillam, p. 286

$61 and $69 in Inner and Outer regions respectively"[95] (a difference in cost of approximately 33% between the cheapest and the most expensive credit).

### Default costs charged by Short Term Lenders

There is no universal data about the levels of default in repayments, and the consequent charges payable by the consumer, across the short term lending industry. It is likely the level of default varies significantly, principally because of the difference in charges levied by lenders. Assuming all other circumstances are comparable, a low-income borrower is more likely to default where, for example, as set out in Table 5, they are being charged $195 for a one week loan rather than $41.58.

In this context it is noted that the 2010 Cash Convertors submission to Treasury quotes a bad debt rate of 3.46%.[96] However, it is not possible to extrapolate this figure across the industry, given that Cash Convertors charges lower rates and lower charges than some other industry participants. It would not be surprising if some lenders experienced default rates of 30% or more.

Where a consumer defaults in repayments they become liable to pay default costs to the lender. The most common type of costs are:

- Late payment fees – these can be charged for each day, week or month the payment is late.
- Default interest charges – interest may continue to be charged at the same rate as for the provision of credit, or at a higher rate. An interest rate of, for example, 100% (charged in a State without a cap) that results in a relatively small amount in dollar charges on a four week loan will lead to an exponential increase in the amount of the debt as interest compounds, when it is applied for a longer period of time.
- Loan rescheduling fees – these may be charged where a consumer is unable to meet payments as they fall due under the repayment schedule. The loan reschedule fee may occur independently of, or in addition to, default fees.

The table below sets out the default charges payable by consumers as specified in the credit contracts in relation to a number of current lenders.

[95] MISC, p. 75. Note that these figures relate to loans provided by "subsidiary micro-credit providers" and include "micro-credit products and services that are provided by non-mainstream for profit lenders. This includes payday lenders, payday loans; loans against goods, unsecured personal loans, short-term loans, small consumer loans and title loans."
[96] Cash Converters 2010, p. 10

**Table 6: Default charges levied by short-term lenders**

| Lender | Late fees | Direct debit dishonour fee* | Loan reschedule fee** | Default interest rate |
|---|---|---|---|---|
| A | $75 per day that a payment is late. | - | - | |
| B | $30 per $100 outstanding (pro rata per day) | $150 | | 47.5% |
| C | - | $33 | $7 | |
| D | $7 per day. Capped at 42 days. | $35 | | |
| E | | $30 | $50 | |
| F | $20 when a manual payment is received after due date. | $20 | $20 | 45% |
| G | $48 late payment fee when a manual payment is received after the due date<br><br>$25 monthly fee each month account remains in default | $48 | $20 | |
| H | $15 | $15 | $15 | 45% |

*Note that where a payment is due to be made by direct debit but defaults, a borrower will face additional and separate charges from their financial institution.
** A Loan reschedule fee is the fee charged when a borrower requests that their repayment schedule is changed.

## Consumer Leases

### Background

Currently the Credit Act only regulates leases which meet the following criteria: the consumer has no right or obligation to purchase the leased goods at the end of the contract; the contract is for a fixed period of more than 4 months; and the total amount payable by the consumer exceeds the cash price of the goods (that is, the reasonable market value).

There are two categories of leases that are not regulated by the Credit Act, first, those where the lease is for an indefinite period, and, second, where the initial term of the lease is for a

fixed period of less than 4 months (notwithstanding that both the lessor and the consumer anticipate that the contract will be rolled over on a regular basis).

In summary, the Credit Act applies a lower level of obligations to regulated consumer leases, relative to credit contracts, and does not apply at all to exempt leases. This asymmetry has prompted regulatory arbitrage, with leases being marketed to consumers as an alternative finance product to credit. They are functionally similar to credit contracts, and many consumers may be unaware that they are entering into a contract for a different form of finance product, in which they will not own the goods at the end of the contract (although they may be able to negotiate their subsequent purchase with the lessor).

The RIS in respect of leases recommended that both these types of exempt leases should be largely regulated consistently with credit contracts. Accordingly the discussion below also considers exempt leases (on the assumption that both types of leases will become regulated by the Credit Act).

There are three main different types of retail outlets that offer consumer leases:

- Mainstream retail outlets, including national or multi-store operations.
- Smaller outlets, often with only a single store, that largely rely on local custom and where the consumer is only given the choice of financing the acquisition of goods through a lease.
- Operators with no retail presence who engage in door-to-door marketing of household goods to remote and primarily Indigenous communities, particularly in rural New South Wales and the Northern Territory.

Industry sources estimate that the smaller retail outlets largely, but not completely, offer exempt leases and that these lessors have 20% of the market share (based on the number of contracts rather than the value of those contracts). The extent of the activities of the operators who visit remote communities is not known, but they can arrange contracts with a value of over $100,000 on a visit to a single community.

The nature of the exemption relied on by the lessor can have different consequences for consumers, as follows:

- where the lease is for an indefinite term – the consumer must keep making payments as long as they retain possession of the goods, that is, potentially for an indefinite length of time; and
- where the lease is for an initial period of 4 months or less – the lessor and the consumer may both have an expectation that the consumer will retain possession for longer than 4 months (and the lessor may advertise the availability of the goods in that way), but the terms of the contract, in relation to the total amount payable by the consumer, will not reflect that expectation.

### Use by low-income consumers

As discussed above, there are three main types of businesses that offer leases. There is a clear differentiation between these providers, in that the larger retail outlets will offer both

leases and credit contracts, and therefore do cater to consumers who can access mainstream products.

Generally the smaller retail outlets and the operators who visit remote communities predominantly sell relatively cheap household goods (rather than, for example, computers or other items that are regularly being updated or improved), and use leases to provide those goods to low-income consumers who cannot access alternative means of credit.[97] Typically these businesses will offer a large range of goods with a cash value of below $1,000, with leases being used to provide what is, in substance, a form of small amount finance.

The use of leases typically has a number of structural disadvantages compared to credit contracts that make them a less economically rational selection and can, therefore, result in a significant adverse financial impact on low-income consumers. These disadvantages are:

- The cost is significantly higher than credit provided through a credit card or an 'interest free' arrangement. The total payments under a lease regularly can amount to twice the market value of the goods, so that the consumer can pay nearly double the amount relative to an 'interest free' arrangement (alternatively, the consumer could use an 'interest free' transaction to purchase goods with double the value).

- The consumer does not own the goods at the end of the contract, and must make additional payments, either to purchase the goods (where the lessor allows this), or on an ongoing basis in order to retain possession and continue to be able to use them. This outcome is particularly financially disadvantageous to low-income consumers where they are leasing cheap or basic household goods as these consumers are more likely, because of their income constraints, to want to maximise the benefits obtained from the goods, by continuing to use them for as long as possible, rather than wanting to upgrade to newer or replacement goods.

Given these consequences it is considered that generally consumers would not need to use leases if they were either able to pay cash or access other, cheaper mainstream credit options to pay the relatively modest amounts necessary to own the items outright. Leases are therefore disproportionately used by low-income consumers to acquire goods because they do not meet the eligibility criteria of lenders who offer credit contracts.

Given that consumers are limited in their choices by their income, so that they are unable to satisfy the eligibility criteria of a range of lessors, they are only able to obtain possession of the goods by accepting the terms offered by those lessors who are prepared to provide them with finance. As a result, the lower the consumer's income the fewer choices they will have, and the greater the risk they will be charged high costs.

The extent of the demand for leases by low-income consumers also means that if a consumer defaults in payments then the lessee is at minimal risk of loss as they can simply take possession of their goods and re-lease them to another consumer. There is therefore only a limited financial incentive for lessors to reduce repayments (and therefore the overall cost).

[97] The larger retail outlets are not marketed to low-income consumers to the same extent, with the major operations offering consumers a choice between credit contracts and leases.

In summary, there is currently a dysfunction between the way in which leases operate, and the way in which they are regulated by the Credit Act, in that they are an attractive way of suppliers providing low-value goods to consumers, but have significant disadvantages for this class of consumers, and can result in them paying more in dollar terms for the goods than consumers with higher incomes.

### Level of costs charged by lessors

The difference in cost charged by three lessors was examined by the Micah Law Centre, in its 2007 report into consumer leases, titled 'A loan in lease clothing: problems identified with instalment based rent/purchase contracts for household goods'. The following Table sets out the interest rate in respect of 7 household items, calculated as if the transaction was a credit contract (noting that the interest rate would be higher than that stated in the Table where the consumer also has to pay an additional amount at the end of the contract to purchase the goods).

**Table 7: Micah Report: Comparison of charges by different lessors**

| Goods | Charges by lessor 1 | Charges by lessor 2 | Charges by lessor 3 |
|---|---|---|---|
| 81cm LCD TV | 28% ($15.29) | 41% ($17.94) | 41% ($17.94) |
| 106cm Plasma TV | 28% ($17.19) | 39% ($19.95) | 41% ($20.18) |
| 260L Fridge | 28% ($6.69) | 62% ($9.95) | N/A |
| Washing machine | 28% ($5.71) | 109% ($12.95) | N/A |
| X Box Game system | 25% ($5.49) | 142% ($15.95) | 40% ($6.93) |
| Playstation portable | N/A | 190%($10.95) | N/A |
| Panasonic camcorder | N/A | 98% ($9.95) | 52% ($6.37) |

Table 7 shows that there is a significant variation in the effective interest rates in these contracts, and how, given the low value of the goods being purchased even relatively small increases in weekly or monthly payments can result in significant differences in this rate.

It should also be noted that the interest rate will be higher where the lessor is leasing second-hand goods, as will happen on a regular basis where the goods have already been leased once and returned into the possession of the lessor. In this case the difference between the value of the goods and the amount being paid by the consumer will be even greater.

In addition, there are particular issues in relation to the way in which both consumer leases and exempt leases have been utilised by door-to-door traders marketing goods in Indigenous communities. These communities are commonly located in remote or regional

Australia, and its members usually have no other or very few alternative sources of finance, or, therefore, for obtaining even basic household goods, such as beds or tables. Individual borrowers are commonly in receipt of Centrelink payments and the lessor relies on payment through direct debit arrangements that are rarely cancelled in practice. As a result, the lessor is able to continue receiving payments notwithstanding that it may result in financial hardship for the consumer.[98]

Table 8 below sets out the total amount charged to consumers by lessors to remote communities for the lease of two common household items, and the cost of the lease as an interest rate (again calculated as if the transaction was a credit contract).

**Table 8: Charges by lessors providing goods to remote communities**

| Goods and Cash Value | Total payments by lessee | Cost of finance | Effective Interest rate |
|---|---|---|---|
| Double bed ($399) | $830 (24 months) | $435 | 83% |
| Washing machine ($849) | $1734 (24 months) | $885 | 83% |

# PROBLEM IDENTIFICATION

## Overview

Short term lending and consumer leases are both products that have a significant risk of financial harm. Consumers on low incomes or who are financially stressed are at risk of long term financial detriment because of the impact that the cost of finance, where it is not regulated or capped, can have on their financial position. Conversely, limiting the financial impact of this form of finance can improve the capacity of the borrower to stabilise or improve their position.

Consumers can be charged costs that, given their financial position, create a risk of:

- ongoing payments to the credit provider or lessor for minimal, or diminishing, benefit;
- a debt spiral, where an increasing percentage of the consumer's income is used to meet repayments under a contract; and
- an ongoing cycle of disadvantage, that reduces the potential for financial and social inclusiveness of this class of consumers.

## Short term small amount lending

[98] See *Unconscionable Conduct and Aboriginal and Torres Strait Islander Consumers* Research Report, by Indigenous Consumer Assistance Network Ltd.

The review of the short-term lending market in this RIS identified that the majority of the users of this form of finance have the following characteristics:

- They have low incomes:
  - Approximately 40 to 49% of short term customers have an annual income of less than $24,000, and between 50 to 74% of short term customers have an annual income of less than $36,000.
  - 50% of short term customers are partially employed or unemployed.
  - Between 46 and 50% of short term customers are in receipt of government benefits.
  - Possibly up to 25% of short term borrowers have incomes that are so low that they fall beneath the Henderson Poverty Line.
- Borrowers are largely excluded from being able to obtain credit from mainstream lenders (principally because of their incomes or an impaired credit history).
- Borrowers usually have an urgent or immediate need for credit. The most common uses of the funds are to meet the following costs: bills (including utilities), food, rent, and car repairs and registration. There is minimal or negligible use of short term loans for discretionary spending purposes.
- There are very few procedural obstacles to obtaining credit, with loans able to be processed quickly, making them an attractive way of meeting the need for credit. A consumer's choice of lender is primarily driven by whether or not they can have address their pressing financial needs through quick and efficient access to credit (and that the price or features of the credit are, at best, a secondary consideration).

There are currently a range of alternatives to high cost short term loans, such as Centrelink products (both loans and advances on payments), utility hardship programs, and non-commercial microfinance products (primarily no interest and low interest loan schemes). There are also a range of services available, principally financial counsellors, who can assist borrowers to better understand and address underlying problems.

While it might be expected that consumers in financial stress would be aware of or seek out these alternatives this is not necessarily the case. The 2008 CALC survey found minimal knowledge of these options, in its qualitative surveys.[99] Navigating the range of services available to identify appropriate options can prove a formidable task for disadvantaged consumers, and a lack of information "can impact on people's capacity to make informed decisions and actively participate in the life of their community." [100]

It is also noted that a recent survey of 5,315 respondents had findings that demonstrated a low knowledge by consumers of relatively basic consumer protection issues.[101] These findings were:

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[99] Gillam, p. 264.
[100] Julia Farr Association, 2010, Submission to the Social Inclusion Board.
[101] Australian Consumer Survey, June 2011, pp. 11 and 26.

- 10% of consumers were unaware that laws exist to protect them when purchasing products or services in Australia; and
- 10% of consumers did not know where they would go to seek advice or assistance if they felt they had been exploited by a business.

This combination of factors means that borrowers will utilise short term lenders, even where other cheaper alternatives may be available, The level of costs that they may be charged as a result can increase the risk of social exclusion, and in the long-term can impair further their already restricted financial capacity.

The following tables use data provided in Table 5 above (setting out the range of charges for loans of identical amounts and terms). They show the charges of the highest cost and lowest cost charges for each loan, and the impact of those costs on a consumer with an assumed income of $24,000 per annum, looking at the impact both where they take out a single loan and two consecutive loans. It is assumed, first, that the loans are repaid in accordance with their terms, and without the borrower incurring any default charges, and, second, in respect of the consecutive loans, that 25% of the amount advanced is used to repay the amount outstanding under the first loan (as where the borrower requires two loans in succession they are presumed to be unable to repay the first loan from their own income).

**Table 9.1: Impact of high and low cost credit on income from a single loan**

| Loan amount | Duration of loan | Cost for a single loan | Income during loan period (assuming annual income of $24,000) | Cost as a% proportion of income during loan period |
|---|---|---|---|---|
| $300 (LC) | 1 week | $41.58 | $461.54 | 9.01% |
| $300 (HC) | 1 week | $195.00 | $461.54 | 42.25% |
| $1000 (LC) | 1 week | $68.15 | $461.54 | 14.77% |
| $1000 (HC) | 1 week | $231.01 | $461.54 | 50.05% |
| $300 (LC) | 4 weeks | $50.68 | $1846.16 | 2.75% |
| $300 (HC) | 4 weeks | $113.72 | $1846.16 | 6.16% |
| $1000 (LC) | 4 weeks | $151.64 | $1846.16 | 8.21% |
| $1000 (HC) | 4 weeks | $254.52 | $1846.16 | 13.79% |
| $1000 (LC) | 1 year | $622.68 | $24,000 | 2.59% |
| $1000 (HC) | 1 year | $2074.76 | $24,000 | 8.64% |

LC = low cost. HC = high cost

**Table 9.2: Impact of high and low cost credit on income from consecutive loans**

| Loan amount | Duration of loans | Reduction in income after payments to credit provider | Reduction in income during loan period |
|---|---|---|---|
| $300 (LC) | 2 weeks | $158.16 | 17.13% |
| $300 (HC) | 2 weeks | $465.00 | 50.37% |
| $1000 (LC) | 2 weeks | $386.30 | 41.81% |
| $1000 (HC) | 2 weeks | $712.02 | 77.13% |
| $300 (LC) | 8 weeks | $176.36 | 9.55% |
| $300 (HC) | 8 weeks | $302.44 | 16.38% |
| $1000 (LC) | 8 weeks | $553.28 | 29.96% |
| $1000 (HC) | 8 weeks | $759.04 | 41.11% |

LC = low cost. HC = high cost

These tables demonstrate that:

- short term loans can have a significant impact on a borrower with an annual income of $24,000, resulting in a reduction of income of between 2.59% and 50.05% for a single loan, and between 9.55% and 77.13% for consecutive loans (noting that the impact will be greater on those borrowers whose income is below $20,000); and

- consumers may, in a very short period, be placed in a position where the debt cannot be easily repaid, given that persons on low incomes or in receipt of Centrelink payments are unlikely to experience significant changes to their income between payments.

The risk to a consumer of this financial detriment increases according to the following factors:

- The borrower's income – the lower the income the greater the reduction in income.

- The term of the loan – the shorter the loan the less income the borrower can expect to receive, so that there is little or no opportunity for a borrower to put aside sufficient income to repay the principal plus associated charges, so that the impact will be greater in relation to loans with terms between one week and one month.

- The number of loans – the more loans that the borrower takes out within a short period of time, the more likely it is that income is being diverted to meet repayments, rather than ongoing expenses.

The financial position of some borrowers, together with the level of costs charged by some short-term lenders, can result in such a reduction in income that the consumer may, in a very short period, be placed in a position where the debt cannot be repaid. If the consumer cannot make the repayments, they have two options:

- to default and incur consequent fees and charges; or

- to take out a new loan to meet the liabilities under the old contract (with the risk that this may only defer the point at which default occurs, and for a larger amount).

Table 10 below sets out the default charges that would accrue under a number of contracts currently offered by short term lenders.

**Table 10: Default charges in dollar terms on a loan of $500**[102]

| Lender | Loan Term | Charges if paid on time | Charges if paid 30 days late | Additional charges |
|---|---|---|---|---|
| 1 | 30 days | $787.50 | $3,037.50 | $2,250.00 |
| 2 | 14 days | $186.00 | $505.89[103] | $319.89 |
| 3 | 14 days | $105.00 | $350.00 | $245.00 |

For those consumers who have a loan with a lender who charges daily default fees, the cost of the loan can escalate rapidly to a point where, for a low-income consumer, they would be unable to meet the additional payments required from their regular income.

The above analysis applies to all short-term credit. However, for the reasons set out above, the circumstances of some borrowers mean that they are particularly vulnerable and unable to make informed choices or negotiate the terms on which credit is provided. This makes them susceptible to unfair conduct. Some short-term credit providers engage in practices that are intended to take advantage of these consumers (and that are regarded as unacceptable by both consumer advocates and the majority of short term lenders).

These practices include:

- Structuring the transaction as a lease to avoid the operation of a State or Territory cap (with the consumer 'selling' goods they already own to the provider, with those goods then being leased back to the consumer, at a cost that is legally in excess of the cap).

[102] Assumptions: daily compounding interest, payment via direct debit. When a loan is paid late, it is paid 30 days late, one direct debit default occurs, one loan reschedule occurs. Default interest is calculated on the principle amount.

[103] Default interest rate is calculated on the amount borrowed, not the fees upon default. The interest is compounded daily.

  - This practice exploits the likelihood that borrowers will not scrutinise or question the written contract provided to them.

- Inflating the number or amount of fees charged to the consumer in relation to the credit contract, in order to artificially increase the principal amount on which interest can be charged.

  - This implicitly acknowledges that some borrowers will not question the terms on which short term credit is provided.

- Deliberately overstating the amount lent to the consumer (for example, as $500 instead of $300), and then charging interest on the higher amount but calculated in accordance with a State cap.

  - This practice exploits the lack of financial literacy of some borrowers, where payment of the loan proceeds to the consumer is in cash.

- In relation to very short term loans, fixing the date for repayment according to when the consumer will next receive a payment of income (which could be as short as three or four days), rather than according to the needs of the consumer.

  - The use of a direct debit, which is unlikely to be cancelled by the consumer, means that the consumer can be required to repay a significantly higher amount (in dollar terms) within a short period, irrespective of the consequent impact on their financial situation.

- Structuring the repayments under the loan contract in a way that maximises the likelihood of the consumer defaulting, so that significant default fees can then be charged.

  - This practice is more likely to be adopted in relation to borrowers who are in receipt of an income through paid employment, where payment of the debt can be enforced through garnishee orders on their employer.

In summary consumer therefore also face a risk of financial detriment from unfair conduct in these situations. The extent of these practices is unknown but consumer advocates and financial counsellors advise that the conduct is systemic (in that if a lender is likely to adopt a practice in relation to all their customers).

### Consumer Leases

A similar dynamic has developed in relation to leases, where low-income consumers make a disproportionate use of a form of finance to arrange the acquisition of goods that is relatively high in cost. As set out above in the RIS, the costs and structure of leases indicates that the class of consumers who largely use leases do so because they do not meet the eligibility criteria of lenders who offer credit contracts, they do not have access to finance through a credit card or they cannot afford to pay cash to purchase the goods.

For this class of consumers leases may typically finance relatively low-cost goods, where the consumer has to make lower repayments than under a short term loan, but for an extended, or even indefinite, period. Consumers may therefore find themselves:

- making payments that they can afford, but without obtaining any long-term benefit in the sense of reaching a point where they own the goods and no longer have to keep making payments;
- having to pay several times more for the use and eventual ownership of the goods than if they had access to alternative forms of finance;
- being liable to pay additional amounts at the end of the lease to retain possession of the goods; and
- being in a position, where they are unable to meet the repayments and default, where they still need to acquire replacement goods (and will have to incur ongoing costs to do so).

The risk of this detriment increases according to the following factors:

- The amount and number of the repayments – the higher these are the more the consumer will be paying, without necessarily ever owning the goods;
- Whether or not the lessor is prepared to sell the goods to the consumer at the end of the term of the contract, and, if so, the amount they charge for this – the higher the cost charged to secure ownership the more likely the consumer will be unable to afford to pay that amount as a lump sum, and may therefore have to make ongoing payments as they continue having to lease the goods;
- Whether or not the leased goods are second-hand – where this is the case the amount the consumer is paying can be much higher relative to the value of the goods (without the consumer necessarily being aware of this); and
- The location of the consumers – individuals in remote communities have limited or no access to alternative sources of finance, and can therefore be charged significantly high costs (in some cases at a level equivalent to an interest rate of 83%).

### Limitations of responsible lending obligations

As discussed above, short term lenders and providers of leases have been required to comply with responsible lending obligations under the Credit Act since 1 July 2012. However, this obligation does not directly address the risks identified above, for the following reasons.

First, the responsible lending obligations require the credit provider or lessor to assess whether or not the consumer can afford the repayments under the contract without substantial hardship, and do not directly impact on the cost of credit. Credit providers and lessors therefore cannot set the repayments at a level the consumer cannot afford to repay. In some situations, this may result in the consumer having to meet lower repayments than would otherwise be the case. However, this would apply on an individual basis, and does not provide a comprehensive response in the same way that an upfront limitation on costs would.

It is noted that the introduction of the responsible lending requirements could be expected to have the greatest impact on very short-term loans with a single high repayment. However, there do not appear to have been any significant changes to practices in this area.

Secondly, the responsible lending obligations require each contract to be considered in isolation. In the case of repeat borrowings this will mean that it is not possible to consider the cumulative effect of a series of contracts with the same lender.

Finally, there are practical limitations in establishing whether or not a consumer can afford the repayments under short-term contracts. For these consumers, it depends on being able to precisely establish what their living expenses are, and this can be difficult in practice.

### Relationship between use of short term loans and consumer leases and social exclusion

The potential impact on consumers from the reduction in their income arising from short-term lending or consumer leases is not only financial. The number of consumers in this class can be estimated by using as a proxy the number of persons who either do not hold a credit card or would be unable to use an existing credit card to raise $3,000 in cash in case of an emergency (that is, they have largely exhausted the credit available through their card).

A recent survey estimates that approximately 1,444,000 individuals would fit into this category, with 11.6% of survey respondents having used a fringe lender to raise funds in an emergency.[104]

Financial exclusion can result in or contribute to a range of broader social problems as the ability of consumers to meet their living expenses decreases, and their standard of living reduces. There can be a reciprocal relationship between low or declining incomes and other problems, so that financial exclusion can cause, reinforce or stem from other elements of disadvantage. The potential problems that can contribute to ongoing social exclusion and a cycle of disadvantage can therefore be self-reinforcing. There will also be an element of self-selection in that consumers who use short-term lenders or providers of leases are more likely to be vulnerable in the sense of lacking the capacity or external support to be able to identify other cheaper forms of credit, or external sources of assistance.

The range of social problems is broad and can include:

- Health problems - 35% of people in lowest income quintile report fair or poor health compared to only 7% in the highest income quintile.[105] People experiencing financial hardship have higher rates of suicide and self-harm than the rest of the population.[106]
- Intergenerational joblessness - jobless families with dependants may not be able to access or provide resources that would assist children in their development (such as healthy foods, educational materials); this increases the likelihood that these dependants will be unable to break free from the cycle of disadvantage.[107]

[104] Connolly, C., Georgouras, M., Hems, L. and Wolfson, L., Measring Financial Exclusion in Australia, Centre for Social Impact – University of NSW, 2011, for the National Australia Bank, pp. 8 and 27.
[105] Australian Social Inclusion Board, Social Inclusion in Australia How Australia is faring, January 2010, p. 1.
[106] Ibid.
[107] Reference Group on Welfare Reform, *Participation Support for a More Equitable Society*, Final Report, FaCS, Canberra, 2000

- Increased incidence of being motivated to commit crimes - 49% of prisoners in a recent Australian study of women prisoners and debt said that they had committed crime to repay a debt.[108]

- Inadequate housing - people experiencing financial hardship are more likely to live in housing that does not meet their needs, with consequent risks on their health or relationships.[109]

- Adverse responses to financial stress - other facets of a cycle of disadvantage may include relationship breakdown, mental health issues, drug use, homelessness and domestic violence.[110] All of these outcomes may precipitate a crisis or emergency that can result in a need for credit.

In conclusion, the risk of financial harm from being charged excessive costs cannot be considered in isolation. It is likely to have a dynamic relationship with other components of disadvantage (such as poor health or housing), such that there can be a propensity for one type of disadvantage to cause or exacerbate the other.

# Objectives of Government Action

The objectives of government action are to:

- assist consumers to have a greater degree of social and financial inclusion; and
- mitigate the particular risks associated with short term credit (and to do so in a way that minimises the risk of avoidance).

# Options

## Introduction

Some of the options discussed below will restrict the level of costs that can be charged by short term lenders. In order to ensure the above objectives can be met, it is therefore necessary to analyse the profitability of the short term lending market.

Providers note that underlying costs and risk means that the costs of arranging short term loans are more expensive relative to the amount being borrowed than larger longer term loans. In submissions to the Green Paper many lenders argued that a 48% cap inclusive of

[108] Stringer, A., CRC Justice Support, Women Inside in Debt, the Prison and Debt Project, Broadway, Sydney, 2000, 10. The project used a combination of research techniques, including a survey by questionnaire of 121 prisoners and 4 follow up interviews, plus focus groups and unstructured interviews with key stakeholders.
[109] Western Australian Council of Social Service Inc, ER Factsheet #5
[110] Department of Families, Housing, Community Services and Indigenous Affairs, *Community Development Finance Institutions (CDIs) Scoping Study,* Chapter 1: The Nature of Financial Exclusion, 2009.

fees and interest (as currently applies in New South Wales) was unsustainable for the short-term, small amount lending industry:

- Cash Stop stated that a 48% cap means effectively earning a gross amount of less than $1 per hundred dollars lent per week. In other words for an average four week loan of $350, the lender would gross $14.
- Fast Access Finance stated in its Submission that the current "legislated [comprehensive] interest rate caps are set at a level where the total cost achievable is below primary costs, let alone achieving a profit."[111]
- The NFSF points out that a $10 fee on a $100 week-long loan is the equivalent of an APR in excess of 500%. A $20 fee on a $100 week-long loan would the equivalent of an APR in excess of 1000% per annum fee.
- Min-it Software reported that lenders for whom it provided software in States with comprehensive caps had seen their incomes shrink and that, in the past 2 years, this has resulted in staff losses in excess of 160. Min-it Software stated that it had lost 27 clients due to the interest rate caps in some States and Territories.[112]

The actual cost of providing these loans across the industry has historically been difficult to ascertain, and is subject to a high degree of variability. Costs will depend on the efficiency and scale of the business and the amount and the term of the loans:

- Cash Converters' response to the Green Paper stated that the average cost per $320 transaction was $76.07, and the average profit was $35.93, resulting in a cost to the consumer of $112.[113] Their charges across a range of credit products are set out in Annexure A, and vary from State to State with the cost structure reflecting the regulatory arrangements in different jurisdictions in respect of a cap on costs.
- In 2010 the National Australia Bank reported on the findings from a Small Loans Pilot launched in May 2008. One objective of the pilot was to determine the "viability of a lending model that could operate within the fringe credit market and offer small loans over 12 months at a break-even rate".[114] The loans provided were from $1000 to $5000, and had a term of 12 months.[115] Therefore the study did not provide insight into costs of providing smaller amount, shorter term payday loans. The study emphasised that the cost of providing credit was very much dependent on loan amount, loan term and the size of loan portfolio.[116] It found that:
  - It was possible to provide loans of approximately $2900 over 12 months, with a portfolio of 3000 loans, make a modest profit and be below the government regulated interest rates of 48% per annum. A 32.8% APR was needed to break

[111] Fast Access Finance, 'Response to National Credit Reform Green Paper' 2010, p. 14
[112] Min-it Software, p. 17
[113] Cash Converters, 2010, p.10
[114] NAB Loans Pilot, Foreword. Note that there are likely to be cost differences for a major ADI lender conducting a specialist pilot program with sophisticated record keeping and lending protocols and smaller or single person lending businesses conducted from suburban shop fronts.
[115] Note that not all applicants were successful in accessing the loans.
[116] NAB, p. 12

even on loans of this size (or $18.70 interest for every $100 lent). [117] If a modest profit of 20 cents in the dollar was added, an APR of 39% would be needed.[118]

– Assuming the same costs, it reported that 'it is not possible to make a profit and legally operate with the 48% per annum cap for loans of $1700 or smaller, for a portfolio of 3000 loans or less, for loan terms of one year or less". For a company writing $100 million of loans per year, the smallest average size loan possible would be $605 at an APR of 48% (making a profit of 20 cents in the dollar). This lender would need to write 165,000 loans per year. [119]

The data would suggest that approximately $20 to $30 per $100 is required to generate a reasonable return on providing loans up to a certain limit (under $300), noting that this will vary between lenders and that the shorter the loan term the higher the repayments will need to be to generate a return. After this point, it could be expected that costs would reduce relative to the amount borrowed (as the majority of the costs incurred by the lender arise in arranging the loan do not vary according to the size of the loan).

It is noted that Ernst & Young LLP prepared a report on payday lending costs for the Ontario Government in 2009. The analysis was based on a survey of the cost structures of nine payday lenders in that province. Based on the (unaudited) information received Ernst & Young calculated a weighted average cost of $21.50[120] per $100 lent.[121] Although operating in a different market, the figure provides some indication of costs of the business. Ontario has implemented a cap at this rate ($21 per $100 lent). Other Canadian jurisdictions have taken a similar approach with caps varying from $17 to $31 for every $100 borrowed.

Annexure B shows the approach to capping taken in Europe, the United States and the United Kingdom. Many countries have chosen this avenue as a way to moderate fees and charges for credit.

The way in which Options 1.1, 1.2 and 1.3 would result in the application of a cap are summarised below.

**Table 11: Summary of Options 1.1 -1.3**

| Option | Commonwealth regulation | State and Territory regulation |
|---|---|---|
| 1.1 Maintain the status quo | No legislation | Regulation of costs through different caps |
| 1.2 Cap on costs – flat-rate | All contracts subject to the same cap. | State and Territory laws may be repealed. |
| 1.3 Cap on costs – | Contracts subject to a cap with cap determined according to the loan | State and Territory laws |

[117] NAB, p. 4
[118] NAB, p. 13
[119] NAB, p. 13
[120] $22.07 unweighted
[121] Ministry of Small Business and Consumer Services Ontario 'The Cost of Providing Payday Loans in Ontario' 2009, p. 2

| tiered approach | amount and the term of the contract. | may be repealed. |
|---|---|---|

## OPTION 1.1 MAINTAIN THE STATUS QUO

Under this option, the Commonwealth Government would not introduce further regulation that would impact specifically upon short term lending, including the cost of short term credit.

Under this option, governments may either elect to continue existing State and Territory interest rate caps or, over time, introduce caps (noting that South Australia was proceeding with this approach prior to the transfer of responsibility for credit to the Commonwealth). It is noted that the Intergovernmental Agreement for Credit would still allow States and Territories the option of regulating the cost of credit.

Phase One of the National Credit Reforms will have an impact on the small amount lending market through the introduction of, first, a requirement for such lenders to hold an Australian credit licence (where they provide products that are regulated by the Credit Act), and, second, responsible lending requirements.

These changes (relative to the regulatory scheme previously operating in the States and Territories) will have the following impacts:

- Licensing requirements will enable ASIC to ban credit providers who consistently do not comply with the Credit Act, or other legislation, in their dealings with borrowers.
- Responsible lending will require credit providers to specifically consider whether the consumer can afford the repayments under a short term contract without substantial hardship, and whether it meets the borrower's requirements.

These new requirements do not directly regulate the cost of lending and will therefore have a marginal impact on the problems associated with the cost of short term lending and the consequent risk of financial harm to consumers.

### Impact on Consumers

There will be no new impacts on consumers under Option 1.1, or any change from current arrangements. There will continue to be different controls over the cost of credit according to the State or Territory in which they reside.

This may change over time depending on the approach taken by States and Territories in response to a Commonwealth decision to not introduce interest rate caps (noting that all consumers will have the benefit of Phase One of the National Credit Reforms), and whether those jurisdictions without a cap introduce one.

### Impact on Short Term Credit Providers and Lessors

As the approach to interest rate caps varies across the different Australian jurisdictions , national providers of short term loans will continue to have to comply with different obligations in each State and Territory that has a cap. Lenders will also face uncertainty into the foreseeable future about the existence of caps in other States and Territories, and may face, over time, different regulatory requirements evolving in each jurisdiction.

Cash Converters in its 2010 submission to the Green Paper identified the following costs as multiplying where they have vary from jurisdiction to jurisdiction according to the regulatory requirements in that State or Territory:

- legal drafting and compliance costs;
- information software and technology requirements;
- government and network communications requirements;
- store compliance auditing;
- state-based training requirements;
- store-based training requirements; and
- communications and marketing regulatory compliance.[122]

Payday and micro lenders who currently only operate in States or Territories that do not have a cap would face compliance costs should this situation change.

## Option 1.2 Cap on Costs – Flat-rate

A flat-rate cap currently exists in a number of Australian jurisdictions and is defined as a cap that imposes a single maximum annual percentage rate across the consumer lending market, and applies in the same way to all credit products (rather than varying according to the type of product). It is a '*hard cap*' in the sense that charges in excess of the cap are strictly prohibited (rather than the cap being the trigger for additional conduct or disclosure obligations).

In order to be effective the cap would be need to be comprehensive:

- by applying to all regulated products (including consumer leases) – to address the risk of avoidance that would arise if, for example, the cap only applies to amounts under a specified figure or for a particular term; and

- by applying a broad definition of the costs that are to be taken into account in determining whether the cap has been exceeded – as otherwise additional costs can be imposed on customers by increasing the amount payable in respect of costs not specified as being included in the cap. The scope of the definition of costs to be taken into account would address structures that have been historically used to avoid the effect of price caps in the States and Territories (for example, the artificial use of brokers to increase the amount of fees charged to the borrower or the charging of deferred establishment fees that are expressed as contingent in the contract but are payable in practice).

[122] Cash Converters 2010, p. 16

The use of consumer leases creates particular difficulties for low-income consumers. However, it is also the case that regulating the cost of credit contracts and not regulating the cost of consumer leases would encourage avoidance techniques that rely on 'artificial' consumer leases (noting that some stakeholders suggest this is already happening in response to the caps in New South Wales and Queensland).

As a flat-rate cap is inflexible it can have the following consequences:

- The cap can be set relatively high, in order to take into account the higher costs charged by a particular subset of the market, with the consequence that the regulation is largely ineffective for other sectors of the market.
- The cap can be set too low, and therefore risk putting out of business large parts of the market (as has been argued in relation to the current cap in New South Wales, of 48%).

This issue was identified by the 1973 UK Inquiry into Consumer Credit Reform, with the Government stating that "It would not be realistic to try to set a rate which could be reasonably applied to every type of transaction. Whether a rate is excessive essentially depends on such circumstances as the size and duration of the loan, whether it is secured or unsecured and, if unsecured, the credit worthiness of the borrower".[123]

The flat-rate cap would be set at a level, based on the experience of the States and Territories, which sought to minimise these consequences.

Consumer leases would be subject to a cap determined according to the underlying value of the leased goods, rather than the amount borrowed.

### Impact on Consumers and Short Term Credit Providers and Lessors

The impact of a flat-rate cap on consumers and providers will vary depending on the level at which the cap is set up:

- If it is set at a high level, it may have little impact on lenders and provide minimal new protections to borrowers.
- If it is too low, it may restrict the availability of short term credit by limiting charges to such an extent that short term lending businesses becomes unprofitable. The consequences of this could be either greater exclusion from the credit market of certain sections of the Australian population, or the emergence of an unregulated market in short term credit.

However, on the assumption that a flat rate cap is set at the same level or a similar rate to the existing cap in New South Wales and that it is comprehensive (in that it includes both fees and interest), this reform is likely to have the following consequences for lenders:

- Some lenders would exit the market – There is evidence that following the introduction of comprehensive caps in New South Wales and Queensland at least 27 lenders have ceased trading in the last two years.[124] These lenders are most likely to be smaller businesses who find the cap makes lending unviable, or those running an inefficient

[123] Department of Trade and Industry, Reform of the Law on Consumer Credit, 1973, quoted in Office of Fair Trading, 'Report of the Review on High Cost Credit' Annexe B – Price Controls, 2010, p. 28
[124] Min-it Software, p. 17

business model. This impact would be greatest in those jurisdictions that do not currently have a cap (Northern Territory, South Australia, Tasmania and Western Australia), and more limited in other jurisdictions that have already adapted to existing caps (where the majority of lenders who could not operate with a cap may already have exited the market).

- Some lenders would continue to operate but seek to recover a similar level of costs to those they currently receive by adopting a range of methods to avoid the comprehensive cap – At least nine different avoidance techniques have been developed in New South Wales and Queensland, including the use of other exemptions, provision of finance through continuing credit contracts or leasing arrangements, and mandatory requirements for borrowers to purchase additional goods or services from the provider.
  - Lenders whose primary motivation is to earn as high a return as possible from borrowers are likely to utilise avoidance techniques.
  - These avoidance techniques create a range of new problems for consumers, including a lack of transparency in disclosure, and a continuing risk of financial harm, so that the regulation may be ineffective in achieving its desired outcomes. It would therefore be necessary to address this risk through applying the cap in a way which mitigates the scope for avoidance, and addresses identified techniques.
- A small number of lenders may continue to operate by complying with the cap. This particularly applies to larger lenders who are better able to provide lower-cost loans through economies of scale, and are more likely to have a market presence which means that they can attract a greater share of those consumers who previously used those lenders who have ceased operating.
  - These lenders would have lower revenue per contract, but have a larger volume of contracts. They would also incur compliance costs in implementing the cap (although, for national providers, this would be partially offset by no longer having to meet varying obligations in different jurisdictions).

This change in the market would allow consumers continued access to short-term credit as follows:

- From a small number of lenders who comply with the cap – where the cost of credit would be cheaper than is currently the case.
- From other lenders who structure the transaction to avoid the cap – where the cost of credit is likely to be similar to current charges, but the contracts would be more complicated, and the cost of credit disguised or understated (for example, because the consumer must also purchase other goods or services from the credit provider).

It may also result in some borrowers being refused credit when this would not have been the case previously, where the return that can be earnt from contracts with these borrowers is deemed insufficient to justify the risk. It is considered that this would be a relatively small number of borrowers as, first, it would only be an outcome in those jurisdictions that currently do not have a cap, and, second, the difference in risk is unlikely to be significant in dollar terms for lenders where they are advancing small amounts (that is, they may respond

to this change not simply by refusing credit but, for example. providing smaller loans). This outcome would not be new, in the sense that there are currently persons who are unable to access any form of credit, even of a short term nature, and who therefore need to utilise existing Government and community services.

The experience in New South Wales and Queensland suggests it is unlikely that there would be any significant increase in loan sharks (defined as lending that is characterised by extremely high costs and where payment can be extracted by threats of violence, due to links with criminal activity). In these States, the primary response from mainstream short term lenders has been avoidance rather exiting the market, so that any gap from a reduction in the number of lenders is filled by other short term lenders rather than loan sharks. It has been suggested that part of the reason for this is that consumers usually are unacquainted with loan sharks, and are therefore unlikely to resort to them.

This experience is consistent with a recent review of interest rate restrictions in the European Union, which found that there was no evidence to establish that controls on costs had caused growth in any market in illegal credit, and found indicating that the presence of illegal lending is more significant in countries *without* interest rate restrictions, suggesting that illegal lending is more attributable to factors other than interest rate caps.[125]

In summary (assuming the flat rate cap was based on the New South Wales model), this option can be expected to have the following costs and benefits:

- It is unlikely to provide significant benefits for consumers, and can be expected to have a limited impact on cost (because of the development of avoidance techniques); and
- It will have a relatively low impact on providers, although it could be expected that some short-term lenders would cease operating in those jurisdictions that do not currently have a cap (Northern Territory, South Australia, Tasmania and Western Australia).

## Option 1.3 Cap on Costs – Tiered Approach

A tiered interest rate cap or ceiling would place a maximum limit on the cost of credit, with the cap adjusted to meet different segments of the market, according to the features or characteristics of the type of credit being extended. A tiered cap, unlike a flat rate cap, is therefore able to take into account the different costs associated with different forms of loan.

Again, in order to be effective the cap would be need to be comprehensive, both in terms of the products it applies to and the costs that are to be taken into account in determining whether the cap has been exceeded.

The maximum cost for different forms of loans would vary according to the following factors: the loan amount, the term of the contract and whether security has been taken. A

[125] iff/ZEW (2010): Study on interest rate restrictions in the EU, *Final Report for the EU Commission DG Internal Market and Services*, Project No. ETD/2009/IM/H3/87, Brussels/Hamburg/Mannheim, XIII

tiered cap would limit the maximum amount charged using a different formula for different segments as follows:

- For short term small amount loans – a total charge for credit based on a cap for each hundred dollars advanced, with this also adjusted according to the term of the contract.
- For all other regulated forms of credit – an annual percentage rate.
- For default costs – a cap on costs so that, for example, an annual percentage rate of 48% cannot continue to be charged on an ongoing basis.

The rate at which the cap would be set would be determined as follows:

- For short term loans – taking into account the lowest amounts commonly charged by short term lenders in Australia (enabling the cap to be set at a level that results in consumers paying a controlled price for credit, while still allowing some lenders to achieve a return on this type of lending that allows for a profit).
- For all other regulated forms of credit – the annual percentage rate would be set taking into account the experience of the cap in the States and Territories where it currently operates.

The definition of a short term small amount unsecured loan would also be the subject of further refinement, but is likely to cover loans of $2,000 for a period of either 12 or 24 months.

Similarly consumer leases would be subject to a tiered cap, but with the cap determined according to the underlying value of the leased goods, rather than the amount borrowed (so that the cap for short-term leases is set at a maximum figure for each $100 of the value of the goods, and for other leases the maximum charge allowed would be a charge calculated as an interest rate (using the market value of the leased goods as an equivalent to the amount financed).

The differences in costs that can be charged between this approach and that in Option 1.2 are summarised in Table 12 below (assuming that a rate of $30 per $100 advanced is allowed).

**Table 12: Comparison of costs payable under Option 1.2 and 1.3**

| Loan amount and term | Option 1.2 Flat rate cap (48% per annum) | Option 1.3 Tiered cap<br>$30 per $100 |
|---|---|---|
| $300 for 1 month | $4.81 | $90 |
| $300 for 3 months | $14.43 | $90 |
| $1,000 for 1 month | $21.13 | $300 |
| $1,000 for 3 months | $63.39 | $300 |

Note: The amount earned will vary according to the frequency and amount of repayments under the contract, as each repayment will reduce the principal amount on which interest can be charged.

### Impact on Short Term Credit Providers and Lessors

The tiered cap specifically address the concerns of the short term lending industry who have in the past emphasised that a flat rate cap does not acknowledge the difference between short term credit and other forms of consumer credit. [126] As set out above, it is proposed that the cap would be consistent with costs charged by short term lenders at the lower end of the scale.

This option would have the following consequences for lenders:

- Some lenders will be able to continue to operate and comply with the cap with minimal or no changes to the level of costs they charge.
  - Some but not all lenders would have lower revenue per contract.
  - Lenders would also incur compliance costs in implementing the cap (although, for national providers, this would be partially offset by no longer having to meet varying obligations in different jurisdictions). The main cost would be in adapting existing software to enable loan amounts and terms to be calculated in accordance with the cap. This cost is estimated at between $2,500 and $10,000 for most lenders.
  - Lenders would be under pressure to reduce operating costs.
- Some lenders would exit the market, but fewer than under Option 1.2. By comparison with that option, it is more likely to be those lenders who are reluctant to comply with the cap because they want to keep charging costs that are uncompetitive.
- Some of these lenders would continue to operate but seek to recover a similar level of costs by adopting a range of methods to avoid the comprehensive cap (again requiring specific anti-avoidance measures).

Again, it is unlikely that there would be any increase in loan sharks. This risk would be even lower than under Option 1.2, given that it is expected a larger number of lenders would remain in the market.

In South Africa, the introduction, in 2007, of a tiered cap has had a largely positive impact on the market with commercial institutions coping well, micro-lending continuing to grow and micro lenders extending business by using technology to keep costs to a minimum.[127]

### Impact on Consumers

A tiered cap will have the following consequences:

- It will limit the cost of credit for consumers, so that they will no longer be charged relatively high costs for these types of credit, thereby better enabling them to manage their finances. This will particularly assist those consumers who use short-term lenders who charge higher costs, and where therefore the risk of a debt spiral is greatest.

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[126] Howell, p. 86

[127] M Whittaker, 'South Africa's National Credit Act: A Possible Model for the Proper Role of Interest Rate Ceilings for Microfinance', 28 NW. J. INT'L L. & BUS. 561, p. 573

- It will reduce the incidence of repeat borrowings where this is the result of consumers becoming dependant on short term lenders due to the drop in income they experience when repaying a loan. This will minimise the risk of debt spirals arising from multiple borrowings.
- It allows consumers access to this form of credit through the continued operation of those short term lenders who currently charge costs below or at the rate of any cap (and from those lenders who elect to reduce their costs to come within any cap). It reduces the incentives for lenders to adopt avoidance techniques where they now have certainty about the ongoing nature of regulation in this area.
- Those consumers who experience financial difficulties through multiple borrowings will have debts that are smaller in size, making it easier for financial counsellors and similar agencies to resolve their problems where they do seek assistance.

### Impact on other Credit Providers

This reform would be expected to have a minimal impact on other credit providers, as the operation of the existing caps has only identified one situation where mainstream products are inadvertently regulated by the cap. This is where bridging finance is provided to a borrower - between the sale of one property and the purchase of another – and the amount of charges may be relatively high where the bridging is only provided for a very short period. This situation could be specifically exempted from the operation of a cap.

It may be preferable to provide certainty by providing that the tiered cap does not apply to credit provided by an Authorised Deposit-Taking Institution (to avoid any other inadvertent application of these requirements to their products).

In summary, this option can be expected to have the following costs and benefits:

- It maintains the profitability of short term lending for providers, and therefore allows consumers continued access to these products.
- It reduces the risk of financial detriment to consumers resulting from excessive charges.
- It results in compliance costs for lenders, but these are offset by a reduction in compliance costs from inconsistent State and Territory regulation, while the industry has certainty about its continued viability.

## Option 1.4 Specific Protections

This Option proposes a series of specific protections for consumers to address the risks associated with short term lending. These protections could operate as an alternative or as a complement to a hard cap on costs; that is, if a cap on costs is introduced, the definition of the particular types of short term loans that would trigger these additional obligations would be determined so that it applied to loans permitted by the cap.

The following protections would be introduced in relation to short term contracts.

### Restriction on refinancing and multiple loans

The following measures are proposed in order to reduce the extent to which borrowers may make recurrent or regular use of short term lending:

- A credit provider is unable to advance a short term loan to a consumer where the consumer already has a short term loan with that credit provider.
- A credit provider must not use any part of an amount advanced to discharge a liability of a borrower under an existing loan with that credit provider.
- Restricting the circumstances in which a credit provider can renew or extend a short term loan that has not been repaid by its due date, including restricting the charges a lender can impose for extending such a contract.
- Introducing specific responsible lending obligations to address the following situation:
  - where a borrower seeks to enter into multiple short term loans one after the other; and
  - where a provider of credit assistance is assisting a consumer to enter into a short term credit contract, or recommending such a contract, where the consumer is still making repayments under an existing short-term contract.

The first two requirements are intended to address the risk of repeat borrowing by prohibiting this conduct. It is not considered that these changes would have a negative impact on competition between short term lenders as, first, the obligations apply equally to all lenders, and, secondly, some consumer may respond by seeking finance from other lenders and, in consequence, develop a better understanding of the range of lenders and products available.

The third requirement indirectly seeks to encourage lenders to provide loans with longer terms and lower repayments. This is likely to result in better outcomes for consumers as they are more likely to be able to afford those repayments without a significant impact on their financial position.

The introduction of new responsible lending obligations will ensure that lenders and brokers develop practices to address specific high risk practices, while still allowing consumers access to credit in appropriate situations.

These measures are specifically designed to minimise the risk of a debt spiral. These reforms may also indirectly encourage lenders to provide contracts with longer terms and lower repayments, as they can no longer rely, to the same extent, on generating revenue through repeat or multiple borrowings.

### Disclosure requirements

Short term lenders would be required to meet additional disclosure requirements to consumers, including:

- A requirement to disclose the cost of the loan on application (that is, at an earlier point in time than is currently the case, when the cost only needs to be disclosed when the consumer is entering into the contract); and
- where the lender has a website on which applications for credit can be made – a supplementary requirement for the lender to provide comprehensive information about their fees and charges (again to be available prior to application).

The analysis in the RIS suggests that disclosure of fees and costs will have only a limited impact on consumers, as they are primarily motivated by factors other than cost. Accordingly, it is proposed that these requirements would be simple and straightforward in nature, to minimise the costs to lenders.

### Reporting requirements

Short term small amount credit providers will be required to report information annually to ASIC in relation to their short term loan portfolio. This would include information such as: the number of loans, extent of repeat borrowing, average default rates, a list of all fees and charges and the circumstances in which they are charged, and, for lenders with a website, details about compliance with disclosure requirements that apply to internet access.

This will assist in ensuring greater transparency in the implementation of the reforms (given that currently there is low visibility in respect of complaints). This will help identify the consequences of the reforms for future reviews.

The reporting period may only be for a two year period following the introduction of the reforms, with the measuring of usage and outcomes in this way enabling the effectiveness of the reforms to be accurately assessed.

### Impact on consumers

The protections discussed in this option will:

- address some of the high risk features associated with short term lending;
- enable consumers to have continued access to this form of credit, but restrict repeated access; and
- introduce greater accountability of short term providers of finance.

It will not offer the same level of protection, in terms of regulating the cost of credit, as Options 1.2 or 1.3, and consumers may therefore continue to face some of the same risks, in relation to paying relatively high costs for access to credit.

### Impact on Short Term Credit Providers and Lessors

The protections discussed in this option will:

- result in either a decrease in the amount of credit provided or a decline in the rate of growth of these products, as the level of repeat business is reduced, due to constraints in respect of 'rollovers'.
- impose compliance costs on lenders.

### Impact on other Credit Providers

This reform would be expected to have a minimal impact on other credit providers, as the types of contracts to which these protections would apply are generally not offered by mainstream providers.

These protections could, however, be specifically excluded from applying to credit provided by an Authorised Deposit-Taking Institution (to avoid any inadvertent consequences).

In summary, this option can be expected to have the following main costs and benefits:

- It reduces the risk of financial detriment to consumers resulting from repeated use of these products.
- It results in compliance costs for lenders.

## Option 1.5 Encourage Consumers to use Alternative Sources of Short Term Loans or seek Assistance from Financial Counsellors

This option would operate on a standalone basis or complement any of the previous Options. Under this option measures would be taken to encourage greater use of financial counsellors and to promote awareness of the following alternatives to high cost short term loans:

- Centrelink products;
- utility hardship programs; and
- non-commercial microfinance products (primarily no interest and low interest loan schemes).

The scope and operation of these alternatives are set out below, followed by a discussion of the way in which obligations could be introduced to encourage greater use of these alternatives.

### Centrelink products

Centrelink provides lump sum advances of social security payments. The amount and frequency of the advance is limited according to the type and rate of a consumer's benefit. Advance Payments are only available if a person can afford to repay over the following 6 months, and will not suffer financial hardship as a result.

People who are provided with Age Pension, Carer Payment, Disability Support Pension, Widow B Pension and Wife Pension are entitled to up to three advances over a six month period. The cumulative amount is limited by a maximum limit, and all advanced amounts must be above a minimum limit. Limits are determined by a person's benefit payment rate. Once an advance has been paid off further advances may become available.

People who are provided with Abstudy, Newstart Allowance, Parenting payments, Widow Allowance or Youth Allowance benefits are entitled to one advance sum payment per annum of between $250 and $500. The money must be repaid over 6 months by reducing the main payment. The payments are interest free.

Centrelink also provides a pension loan scheme, which is a voluntary arrangement that provides support in the form of a loan (paid in regular fortnightly instalments) for people of age pension vintage, who are not eligible for a pension, or who only receive a part pension, so they can access capital tied up in their assets.

Social Security Hardship benefits are also available to people in severe financial hardship, which can assist people experiencing financial difficulties and cannot be reasonably expected to liquidate (or borrow against) assets at short notice.

### Utility programs

Across Australia energy companies have payment programs designed to assist consumers in hardship. In addition to these programs many States and Territories have concession schemes, rebates and other relief, generally for concession card holders. Annexure C summarises some of the current range of programs available to provide assistance to a consumer who is struggling to meet utility bill payments. National Legal Aid has suggested that there is currently limited awareness of Utility Financial Assistance Programs. Mandatory disclosure of information about the existence of these Schemes by small amount lenders could assist.[128]

The Second Exposure Draft of the National Energy Customer Framework was released in November 2009. The legislation will implement a national regime for the non-economic regulatory aspects of energy distribution and retail, is proposed to come into effect in all States and Territories (except Western Australia and the Northern Territory) between mid-2011 and mid-2013. This will introduce a unified hardship regime, which will require payment plans to be offered to hardship customers and those experiencing financial difficulties.

### Microfinance programs

There are a range of microfinance programs that provide no or low-cost short term small amount loans. These loans are generally only available to low income consumers or consumers in receipt of government benefits. In October 2009 the Government announced targeted funding to support the Good Shepherd Youth and Family Service/NAB No Interest Loans Scheme (NILS), StepUP and AddsUP programs and the Brotherhood of St Laurence/ANZ Saver Plus and Progress Loans programs.[129]

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[128] National Legal Aid Submission

[129] Joint Media Release, Prime Minister and Minister for Families, Housing, Community Services and Indigenous Affairs, '*Financial measures to support struggling Australians*', 15 October 2009.

This support was extended under the 2011/12 Budget, with the Government committing $60.6 million over four years to continue these and other micro-finance and financial literacy initiatives, including $6.2 million over four years to support financial literacy services for Indigenous people across Australia.

Currently, the demand for these products is less than the available supply, so that there is an existing capacity to meet an increase in requests following the introduction of the reforms.

### Implementation

This option would have two distinct aspects: the first would be to impose specific obligations on short term lenders, requiring them to notify borrowers of these alternatives; and the second would be better marketing of the Centrelink advances and government microfinance programs.

Under this option short term lenders would be subject to obligations that would alert potential borrowers to the existence of these alternatives by:

- Providing a concise high impact notice about the existence of these alternatives, prior to the consumer entering into a contract.
- Where the borrower applies online, requiring the lender to display similar information to the borrower before an application can be commenced, together with a hyperlink to the ASIC financial literacy website (so that, to the extent lenders make use of the internet, this technology can be adapted to deliver messages to consumers).
- Where the borrower is in receipt of Centrelink payments, providing consumers with a remedy where it would have been more suitable for them to obtain an interest free advance through Centrelink.

This option would also see existing education or financial literacy programs used to provide information to consumers, to encourage better decision-making by consumers in relation to the use of short term credit and leases. There are currently a range of such programs, including:

- Delivery of financial literacy information through ASIC's new MoneySmart website (http://www.moneysmart.gov.au/). This website offers all Australians personalised money guidance, support and encouragement to empower them to take control of their finances, and could be used to provide tailored information in relation to alternatives to short-term lending and leases (coupled with a requirement on providers to provide a hyperlink on their websites, where they have one).

- Centrelink's Financial Information Service (FIS), which provides individuals with information and assistance regarding specific financial issues (including sensible use of credit and debt reduction options). This free education and information service is available to everyone in the community through Centrelink offices around Australia.

### Impact on Consumers

As noted above there is limited awareness by consumers of alternatives to short term small amount finance. The more disadvantaged or isolated the consumer the greater the likelihood that they will be unaware of these options.

It is expected that disclosure of these alternatives would have the following impacts:

- low-income consumers, for whom small savings in dollar terms can have a significant impact, would have a greater motivation to explore these alternatives;
- borrowers who are in default with a number of other creditors would be likely to use a financial counsellor as a source of advice and assistance that can address the entire range of their problems;
- the repeated provision of this information for borrowers who regularly use this form of credit would, over time, reinforce the availability of these alternatives, and encourage consumers to make use of them as they come to realise the costs involved, and the impact on their financial situation; and
- No Interest Loans Schemes that provide finance for the purchase of household goods are likely to be particularly utilised by eligible consumers as an alternative to high cost consumer leases.

The impact on consumers who decide to use one of the alternatives to a short term loan is likely to be:

- a reduction in the amount the borrower will spend to access credit or obtain household goods (because of the lower charges associated with the alternative products);
- where they use financial counsellors, better management of their income, changes to their spending habits and, overall, less reliance on all credit products; and
- more successful outcomes in relation to mitigating the borrower's dependency on short term lending given that assistance is being provided earlier than would otherwise be the case.[130]

It is noted that the impact of these reforms is likely to vary between different classes of consumers, according to their reasons for seeking short term credit, and their preparedness to address underlying financial problems. It is expected that a percentage of borrowers would still prefer the convenience or accessibility of this form of credit, notwithstanding the cost.

### Impact on Short Term Credit Providers and Lessors

The impact of this reform on short term lenders and lessors will be:

- A reduction in the amount of credit provided (to the extent that consumers are being encouraged to use alternative sources of finance, or being directed to financial counselling agencies that can address underlying financial problems).
- Consequent greater incentives for short term lenders and lessors to be more efficient in the way they operate (with those who charge consumers higher costs because of inefficient business models under greater pressure to change their business models).
- Minimal compliance costs, given that the disclosure requirements proposed are relatively abbreviated.

[130] TNS Social Research, 2010, Breaking the Cycles of Disadvantage, p. 50

### Impact on other Credit Providers

This reform would be expected to have no impact on other credit providers.

In summary, this option can be expected to have the following costs and benefits:

- It allows consumers continued access to these products, but, where they do so, consumers will be informed about other options available to them, with some consumers expected to seek out these alternatives.
- It reduces the risk of financial detriment to consumers resulting from the use of short term lenders and lessors, where consumers take up these cheaper alternatives.
- It results in relatively low compliance costs for lenders (given that the changes are only to disclosure requirements and therefore relatively straightforward to implement on a one off basis).

# CONSULTATION

22 submissions were received that provided feedback about the short term, small amount lending market. Of the 22 submissions, 18 were received from lenders or lender representative. Four submissions were received from consumer advocate organisations.

## CONSUMER ORGANISATIONS

Submissions were received from four consumer organisations. All of these organisations supported price regulation for the reasons explored in the RIS, including a failure of competition in the small amount loan market. They felt that the impact of high cost credit on the vulnerable individuals who they support was unhelpful, and could be disastrous.

The consumer organisations were not enthusiastic about enhanced disclosure. They expressed concerns that contractual disclosure did not generally assist consumers to make informed decisions about credit. They also felt that a prohibition on rollovers was unlikely to ameliorate issues arising from short term credit (because it would not stop people from accessing credit from multiple lenders, or take out a new contract in a short period after having completed a previous one).

Consumer advocate organisations did not believe that the licensing or responsible lending reforms introduced during Phase One would reduce the need for an interest rate cap because neither laws addresses cost. Nor, being principles based laws, are they as easy to enforce as an interest rate cap which would provide a black line for those trying to represent consumers.

These organisations emphasised the importance of other measures, in addition to the cap, such as income adequacy, community development finance and broadening of utility payment schemes, to ensure financial inclusion of low income consumers. They also emphasised the importance of curbing avoidance mechanisms as well as active regulatory enforcement to ensure efficacy of the interest rate cap.

## LENDERS

Many of these submissions reported the high cost relative to principal of providing small amount loans, noting that the administrative costs and loss provision were often similar to large, long-term loans (and therefore higher relative charges are necessary to make a profit). The NAB Loan Pilot, which reported on cost of providing short term loans was referenced frequently in this regard.

A majority of submissions were also concerned that the use of an annualised percentage rate (APR) to determine cost of short term loans was, at best, emotive and, at worst, misleading. The National Financial Service Federation pointed out that $20 charge for lending $100 over one week would equate to an APR in excess of 1000%. A number of lenders suggested the use of a total charge for credit (in dollar terms) as an alternative.

All submissions concentrated heavily on the issue of a national interest rate cap. All lender and lender representatives rejected such a cap. The reasons for this included concerns that a cap would:

- be ineffective due to avoidance. Some lenders may choose to set up complicated structural mechanisms, or other avoidance practices, to avoid the cap;
- reduce the availability of legal short term credit. Some lenders may choose to leave the market due to lack of profitability;
- lead to a black market in credit. If many regulated lenders left the market because of unprofitability this may lead to illegal lending via unregulated loan sharks. It could also encourage the growth of offshore internet-based small amount loan providers. It was argued that charitable no-interest and low-interest programs are not nearly large enough to prevent this from happening.
- be unnecessary. Many submissions expressed the view that in light of Phase One credit reform, including responsible lending and licensing, consumer issues in the short term credit market would decrease. Others contended that market competition can be relied upon to force most usurious businesses from the market.
- be impossible to set at a fair and equitable level. Submissions noted that a flat interest rate cap could be both too low (so that short term lending would no longer be possible) and at the same time too high (so that for larger, longer term loans usurious profit-making would still be possible).
- Generally harm consumers by either: (a) hiding the costs of credit in avoidance structures; or (b) restricting short-term credit for which there is great consumer demand; or (c) making short term credit only available through an unregulated sphere.

Submissions from some lenders endorsed alternatives to a cap, including the following: enhanced and streamlined disclosure (including a total charge for credit disclosed in

dollars); prohibitions on rollovers (with some lenders already having these in place on a voluntary basis); prohibitions on borrowers having more than one loan with the same lender; and controlling the amount and frequency of default fees.

# RECOMMENDED OPTIONS

Options 1.3, 1.4 and 1.5 are the preferred options. It is considered that these options would operate in a complementary way to provide the most comprehensive response to the issues identified in this RIS.

The combined effect of the options would be:

- Consumers would be encouraged to avoid using short term small amount finance through:
  - disclosure of alternative sources of finance or the availability of financial counselling agencies that can provide services designed to address underlying financial problems; and
  - clearer high-impact disclosure of the cost of finance, which may encourage some consumers to make greater use of the alternative sources of finance also disclosed to them.
- Consumers who use short term small amount finance would be at less risk of financial detriment through:
  - being charged lower amounts; and
  - having lower levels of repeat borrowing.
- ASIC would be able to identify and target particular providers who may be adopting high risk practices through the introduction of reporting requirements (for example, providers who report unusual levels of defaults or repeat borrowing).

This approach acknowledges that a range of different requirements are needed in order to address the complexities associated with this issue, and that it would not be a sufficient response to simply seek to change the behaviour of consumers only, or to solely rely on regulating lenders.

Given that the combination of these options is likely to result in a decrease in the number of lenders the following analysis of the impact on competition is provided. It is considered these reforms would have the following consequences on credit providers and lessors:

- The number of lenders could be expected to decrease, although this would primarily be those who would find most difficulty in complying with the cap on costs, either because they currently charge significantly higher levels of costs and are unable or unwilling to adapt, or because they are fringe lenders who engage in unfair practices

such as those described in the *Problem Identification* section in order to maximise the return from borrowers (and who therefore have a minimal interest in providing loans on terms that meet the needs of their customers). It is estimated that lenders who currently provide about 25% of contracts may cease operating, and that nearly all larger lenders would continue to operate.

- New businesses could still enter the market but would be more likely to do either by identifying niche markets (for example, operating in locations where there are few existing lenders to compete with), or, more likely, by utilising the internet (where lower establishment costs are required).
- The overall volume of short term contracts could be expected to decrease, as this reform is intended to reduce the extent of repeat borrowing that creates the greatest risk of a debt spiral.
- Lenders would have little scope to compete on price. However, the as discussed above, the inclinations of the borrowing population mean that cost is usually not the basis for selecting a lender.

The reforms would have the following consequences for consumers from this change in the industry:

- The reduction in competition would not result in an increase in costs to consumers, as the very purpose of the cap is to prevent this.
- Lenders who remain in the market would, by definition, be those who have opted, in response to the cap, to remain in business and are therefore committed to continuing to comply with the legislation. This would mean that consumers would be dealing, to a greater extent, with lenders with higher standards of conduct, as fringe players who deliberately and consistently utilise unfair practices leave the industry.
- It will reduce the incidence of repeat borrowings where this is the result of consumers becoming dependant on short term lenders due to the drop in income they experience when repaying a loan. This will minimise the risk of debt spirals arising from multiple borrowings.
- It will require borrowers to seek assistance from Government or community agencies at an earlier point in time (because they have been refused credit when it would previously have been provided to them), or when the total amount of their debts is smaller (due to the caps on costs, including default charges), and therefore easier to resolve.

In summary, these options are all intended to have a significant and direct impact on short term lending practices. There is a clear relationship between this type of lending and the risk of borrowers experiencing a continuing lack of social or financial inclusion, in that the more one increases the more the other decreases. A benefit to low income borrowers (through, for example lower costs or reduced use of these products) is necessarily a cost to lenders (principally through reduced revenue); a commitment to seeking to improve the position of these borrowers and to address their problems cannot be implemented otherwise.

# IMPLEMENTATION

This reform will be implemented by being included in the package of changes in Part One of Phase Two of the Credit Reforms, though legislation to be introduced in a 2011 sitting of Parliament. This reform will be effected through amendments to the Credit Act which will mean that ASIC will be responsible for administering and monitoring compliance.

Given the specialised nature of this reform government will continue to consult directly with primary stakeholders (short term lenders and consumer groups) about, first, the level at which the cap will be set, and, second, on the detail of the other changes. This will enable an immediate exchange of views beyond these stakeholders and government, rather than it being filtered through third parties, such as industry bodies.

# REVIEW

The terms of the National Credit Law Agreement agreed by the Commonwealth and all States and Territories in 2009, require the Commonwealth to commence a review of the operation of the National Credit Law, no later than two years from commencement.
The review of the effect of the cap can be informed by the additional reporting requirements referred to in Option 1.5 that will provide a detailed summary of the sector as to matters such as the number and type of loans, number of defaults and level of repeat business.

# ANNEXURE A – COSTS CHARGED BY CASH CONVERTERS

| Product | State | Loan E'ment Fee | Brokerage Fee | Account Keeping Fee | Loan Term | APR+ | Default Fee# |
|---|---|---|---|---|---|---|---|
| *Cash Advance (this is an unsecured product)* | QLD, ACT | | 35% of principal | | 30 days | 24% | $16.50 |
| | NSW* | ***Deferred e'ment fee*** | | | 1 - 24 months | 48% | $16.50 |
| | TAS | 35% of principal | | | 30 days | 0% | $16.50 |
| | VIC | 35% of principal | | | 30 days | 0% | $16.50 |
| | WA | 35% of principal | | | 30 days | 0% | $16.50 |
| *Unsecured Loans ($1000 - $2000)* | QLD, ACT | | 35% of principal | | 6 - 7 months | 48% | $33 |
| | NSW | | | | 7 - 24 months | 48% | $33 |
| | TAS | $350 | | | 6 - 7 months | 96% | $33 |
| | VIC | $385 | | $7.50 /week | 6 - 9 months | 48% | $33 |
| | WA | $350 | | | 6 - 9 months | 96% | $33 |
| *Secured Loans ($2500 - $5000)* | QLD, ACT | | 35% of principal | | 12 - 24 months | 48% | $33 |
| | NSW | *Not available in NSW* | | | | | |
| | TAS | $450 | | | 12 - 24 months | 72% | $33 |
| | VIC | $450 | | $7.50 /wee k | 12 - 24 months | 30% | $33 |
| | WA | $450 | | $1/w eek | 12 - 24 months | 72% | $33 |

** Deferred establishment fee applied at customer's discretion. # Default fee includes bank charges for direct debit request default, as well as an element relating to the administration of rescheduling the loan.+ APR = Annual Percentage Rate.*

# ANNEXURE B – INTERNATIONAL APPROACHES

## EUROPEAN UNION

A study was undertaken on interest rate restrictions in the EU between December 2009 and September 2010. It undertook an inventory of interest rate restrictions (IRR) in the European Union countries. IRR were defined to be legal rules that limit directly (caps) or indirectly (rules on the calculation of compound interest). The study found that[131]:

- **Default:** With the exception of two Member States (Ireland and Romania), all had an IRR in relation to default interest
- **Absolute and relative ceilings:** 14 States either had a form of an absolute ceiling (Greece, Ireland, Malta) or a relative ceiling based on a reference rate (Belgium, Estonia, France, Germany, Italy, Netherlands, Poland, Portugal, Slovakia, Spain, Slovenia). The spread of ceilings was high (Slovenia ranging from 13.2% for a long-term loan to 453% per annum for a short-term loan; France from between 5.72% to 21.63% for different forms of credit)

The study notes a trade-off between "reducing credit access for irrational or uninformed consumers (which is beneficial, as these are protected from becoming over-indebted) and excluding consumers who are able to make appropriate credit decisions (which is negative as it reduces their options to choose from)".

## UNITED STATES

In the United States payday lending is generally regulated at State level with many States maintaining interest rate caps of between 16% - 36%. Some States have also introduced additional or separate protections, for instance, by restricting the number of loans that can be taken out at any one time. In 2007 the Federal government also intervened in the payday lending market by imposing a 36% interest rate cap on loans to US military personnel. The Department of Defence report which inspired the intervention noted that "predatory lending undermines military readiness, harms the morale of troops and their families, and adds to the cost of fielding an all volunteer fighting force."[132]

## CANADA

In Canada, British Columbia has recently introduced a cap on interest and fees on short term loans of 23%. Other protections have been introduced, including a cooling off period, prohibitions on rollovers (including using a new loan to pay out a previous one). Quebec has an interest rate cap of 35%, and Manitoba a cap of 17%.[133]

[131] European Commission, 'Consultation Document on the EU Study on Interest Rate Restrictions in the EU", Brussels, 25 January 2011

[132] Department of Defense, 'Report to Congress on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents', 2006, p. 9

[133] Office of Fair Trading, High Cost Consumer Credit (Emerging Evidence from the Review), 2009 16 – 17.

## UNITED KINGDOM

In the United Kingdom, consideration was given to the issue of high cost credit by the Office of Fair Trading in 2009 – 2010. In its findings it reported that "in some respects, the markets for high-cost consumer credit can be seen to be working reasonably well. The OFT does, however, have some concerns in relation to these markets arising from this review [including that] on the demand side, the relatively low level of ability and effectiveness of consumers in driving competition between providers, given their low levels of financial capability. On the supply side, sources of additional supply such as mainstream financial providers seem to be limited. In such circumstances, competition on price is not effective and prices are high."[134]

The final report rejected the introduction of an interest rate cap, partially after consideration of research provided by Policis which drew a number of conclusions about the impact of interest rate caps in other markets – including France, Germany, Japan and the US. Policis raises a number of concerns about:

(a) possible restriction on the supply of short term credit encouraging consumers into revolving credit products or leading to financial exclusion;
(b) general ineffectiveness or avoidance of the cap by lenders restructuring their products; and
(c) a growing black market supply of credit.

The methodology, assumptions and conclusions of the report have been criticised by a number of academics, including credit specialists in the countries about which the report draws conclusions.[135] The impact of interest rate caps varies significantly based on the level at which the cap has been set (if it is too low it will inevitably lead to a restriction of credit); the regulatory framework that exists in the country in question; and how credit is provided in the country in question (for example, banks, non-bank lenders).

Despite the OFT recommendations, Labour MP Stella Creasy has introduced a Consumer Credit (Regulation and Advice) Bill, which is due for second reading in February 2011. The Bill includes a cap on the total charge for lending.[136]

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[134] Office of Fair Trading, Press Release, http://www.oft.gov.uk/OFTwork/credit/review-high-cost-consumer-credit/

[135] Office of Fair Trading, Annexe B, p. 45 - 46 summarises the concerns that were provided to them in submission. They included that the research does not fulfil the basic tenets of social research such as the need to contribute to knowledge in a reliable, and transparent way; the report contains methodological and analytical problems and makes statements and conclusions that are not supported by the data provided; provides inadequate sourcing of evidence; fails to define key terms used in the surveys; imakes unjustified assumptions; fails to utilise relevant data from the countries it purported to assess (for instance public collected statistical information); comes to erroneous conclusions about cause and effect (for instance it fails to recognise that the lack of credit product diversity in Germany is due to German banks monopoly on cash credit rather than interest rate caps). See also U Heifner, IFF “Comments on the DTI Study The effect of interest rate controls in other countries – Germany, France and US, Hamburg 2004.

[136] www.independent.co.uk/money/loans-credit/simon-read-the-battle-to-beat-legal-loan-sharks-hits-westminster-2126538.html

# ANNEXURE C – UTILITY FINANCIAL ASSISTANCE PROGRAMS

| Jurisdiction | Options |
|---|---|
| Victoria[137] | • Payment plans if consumer is in financial hardship.<br>• Utility relief grant from the Victorian government (normally concession card holders but some flexibility around this)<br>• Centrelink recipients may be entitled to concession rates and grants |
| WA[138] | • Payment plans if consumer is in financial hardship.<br>• Energy Rebate: the Government provides a range of subsidies and rebates to assist with energy costs for a range of people including those at financial disadvantage.<br>• Hardship Utilities Grant Scheme: This scheme can provide a one-off grant of up to 85% of the amount that a household owes to an energy or water retailer. It also refers people to a financial counsellor for counselling. |
| ACT[139] | • Payment plans if consumer is in financial hardship.<br>• ACT Civil and Administrative Tribunal is empowered to order continued supply despite failed payment, to set up payment schedules and to discharge part or all of overdue account. |
| NSW[140] | • Retailers are required to make two offers of a payment plan to a residential customer experiencing financial difficulties before the retailer can move to disconnect the customer.<br>• A number of rebate programs and energy account vouchers are available.<br>• Free financial counselling services offered. |
| Tasmania[141] | • Payment plans if consumer is in financial hardship.<br>• Rebates available to consumers with concession cards; |

[137] http://www.moneyhelp.org.au/Housing-costs/Energy-and-water-bills.html accessed 10/02/2011
[138] http://www.energy.wa.gov.au/2/3265/64/financial_hardship_assistance.pm accessed 10/02/2011
[139] http://www.acat.act.gov.au/category.php?id=3
[140] http://www.industry.nsw.gov.au/energy/customers/questions-electricity-gas-prices accessed 10/02/2011
[141] http://www.concessions.tas.gov.au/concessions/electricity_and_heating; http://www.energyombudsman.tas.gov.au/making_a_complaint/frequently_asked_questions#five

| | |
|---|---|
| | • Additional concession payment available in form of credit to account |
| Northern Territory | • Payment plans if consumer is in financial hardship.<br>• Rebate available for concession card holders |
| QLD | • Payment plans if consumer is in financial hardship.<br>• Electricity and gas rebate available.<br>• Free financial counselling services offered. |
| South Australia[142] | • Payment plans if consumer is in financial hardship.<br>• Energy concession available |

[142] http://www.eiosa.com.au/faq.html