

The Senate

Economics
Legislation Committee

Consumer Credit and Corporations
Legislation Amendment (Enhancements)
Bill 2011 [Provisions]

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Senate Economics Legislation Committee

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Chapter 1

Introduction

1.1 The Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 was referred to the Senate Economics Legislation Committee ('the committee') on 22 September 2011 for inquiry and report by 23 November 2011. On 10 November 2011, the committee was given an extension of time to report until 30 November 2011. On 25 November 2011, the committee was given a further extension until 7 December 2011.

1.2 On 22 September 2011, the House of Representatives referred the bill to the Parliamentary Joint Committee on Corporations and Financial Services ('the PJC') for inquiry and report. The PJC tabled its report on 2 December 2011.

1.3 The PJC received 53 submissions to its inquiry. It held a public hearing in Canberra on 24 October 2011 where it took evidence from 19 different organisations.

1.4 The Senate Economics Legislation Committee received 38 submissions to its inquiry. Only two of these submissions were not provided to the PJC inquiry.¹ On the other hand, the PJC received submissions from key stakeholders containing important evidence that this committee did not.²

1.5 The committee decided that, given the PJC was planning a public hearing and was to report earlier, it would not conduct a public hearing on this occasion. The committee resolved to base its report and its findings on that of the PJC. By and large, the recommendations made in this report mirror those in the PJC's report.

1.6 The committee thanks all those who made submissions to this inquiry.

The bill

1.7 The bill would amend the *National Consumer Credit Protection Act 2009* (NCCP Act). The NCCP Act implemented a national framework for the regulation of consumer credit by the Commonwealth. The Explanatory Memorandum (EM) states that the bill seeks to amend the NCCP Act to:

- make it easier for debtors to seek a variation of the repayments under their contract due to financial hardship;

1 These were from QBE Insurance and Dr Therese Wilson from Griffith Law School.

2 For example, the PJC received submissions from the Credit Ombudsman Service, Mortgage and Finance Association of Australia, Aussie, Can Do Credit Pty Ltd, National Legal Aid, Action Cash, Fundco Pty Ltd, Action Finance and SEQUAL, among others.

- assist consumers to make more informed choices on reverse mortgages, including a statutory protection against negative equity and improved disclosure requirements;
- cap the maximum amount that credit providers can charge under credit contracts, introduce new disclosure requirements in relation to small amount contracts (such as 'payday' loans) and restrict multiple borrowings and refinancing of those contracts; and
- provide greater regulatory consistency between consumer leases and credit contracts to address regulatory arbitrage arising from the current lower level of obligations applying to consumer leases.³

1.8 The bill also amends the *Corporations Act 2001* to clarify that the chair of an annual general meeting can vote undirected proxies in a non-binding shareholder vote on remuneration where the shareholder provides express authorisation.⁴

Background to the bill

1.9 The bill is part the second phase of the Council of Australian Governments' (COAG) agreement to transfer to the Commonwealth responsibility for the regulation of all consumer credit products, including mortgages, mortgage brokering, margin lending and payday lending. The first phase was completed in July 2010 with the commencement of the *National Consumer Credit Protection Act 2009* (NCCP Act), the National Credit Code,⁵ the *National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009* and the *National Consumer Credit Protection (Fees) Act 2009*.

1.10 COAG agreed that phase two of the transfer would address issues relating to the operation of state and territory consumer credit regulations that had not been resolved at the time responsibility was transferred to the Commonwealth.⁶ This includes the regulation of payday lending, credit cards, store credit, personal loans and investment and small business lending.⁷

1.11 The phase one reforms included the introduction of 'responsible lending requirements' within chapter 3 of the NCCP Act. These requirements ensure that before credit is provided, a credit licensee must assess the suitability of the proposed credit product for the borrower and the borrower's capacity to repay.⁸ The

3 Explanatory Memorandum, p. 3.

4 Explanatory Memorandum, p. 3.

5 The Consumer Code is at Schedule 1 of the NCCP Act.

6 Explanatory Memorandum, paragraph 2.4.

7 Treasury, *National Credit Reform: Enhancing confidence and fairness in Australia's credit laws—Green Paper*, July 2010, p. 106.

8 *National Consumer Credit Protection Act 2009*, s. 111.

requirements are intended to 'lift industry-wide lending standards and further enhance consumer protection'.⁹

1.12 In March 2011, the Australian Securities and Investments Commission (ASIC) released *Regulatory Guide 209* which details the procedures that credit licensees must complete in order to comply with the responsible lending requirements. These are:

- to make reasonable inquiries about the consumer's financial situation and their requirements and objectives;
- to take reasonable steps to verify the consumer's financial situation; and
- to make an assessment whether the credit contract is 'not unsuitable' for the consumer (based on the inquiries and information obtained in the first two steps).¹⁰

1.13 This report refers to 'responsible lending obligations' (RLOs). They refer to chapter 3 of the NCCP Act and the procedures contained in ASIC's Regulatory Guide. The RLOs have applied from 1 January 2011 for authorised deposit-taking institutions (ADIs) and registered finance corporations. For all other credit providers, the obligations applied from 1 July 2010.¹¹

Structure of the report

1.14 This report has three chapters:

- Chapter 2 canvasses the main arguments in support of, and in opposition to, the bill's amendment to cap the maximum amount that lenders can charge on credit contracts. The committee, and the PJC, both received extensive comment on this issue, particularly as the amendments relate to the short-term lending industry.
- Chapter 3 examines the committee's evidence on the bill's provisions relating to hardship variations, reverse mortgages, remedies for unfair or dishonest conduct and consumer leases.

9 Treasury, *National Credit Reform—Green Paper*, July 2010, p. 1.

10 ASIC, *Regulatory Guide 209*, March 2011, p. 4.

11 ASIC, *Regulatory Guide 209*, March 2011, p. 4.

Chapter 2

The short-term loan provisions

Introduction

2.1 Schedules 3 and 4 to the bill propose changes to the lending requirements for short-term lending contracts. The bulk of this committee's evidence—and that of the Parliamentary Joint Committee on Corporations and Financial Services (PJC)—relates to these amendments. As the PJC's report noted, the public debate on the measures in Schedules 3 and 4 have been termed the 'payday loan reforms'.¹ A 'payday loan' is a small, short-term loan that is often used to cover a borrower's expenses until the next time they receive their regular wage. This chapter will use the phrase 'short-term lending'.

2.2 Schedule 3 has the following components:

- a prohibition on the number of contracts that a borrower may simultaneously hold;
- a prohibition on refinancing contracts;
- a prohibition on increasing credit under existing contracts; and
- requirements to provide web-based disclosure statements, which would include a short high-impact statement disclosing the availability of sources of assistance...and cheaper alternative sources of credit'.²

2.3 Schedule 4 would introduce caps on the charges that may be imposed on borrowers under small amount credit contracts, and caps on the costs on certain other credit contracts. For small amount credit contracts, the maximum amount that could be charged is:

- an establishment fee not exceeding 10 per cent of the amount of credit the borrower receives;
- a monthly fee of two per cent of the amount of credit the borrower receives; and
- a fee payable in the event of default, not exceeding twice the adjusted credit amount and any enforcement expenses.³

1 Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Chapter 5, p. 49.

2 Explanatory Memorandum, paragraph 4.23.

3 Schedule 4, item 15, section 39A and section 39B.

2.4 For consumer credit contracts other than small amount credit contracts, bridging finance contracts and contracts provided by an authorised deposit-taking institution (ADI), the bill proposes that the 'annual cost rate' may not exceed 48 per cent. The bill prescribes a formula for calculating the annual cost rate, but also allows other additional amounts charged to be prescribed by regulations. The Explanatory Memorandum states that this regulation-making power is intended to circumvent some lenders' practices of charging the borrower additional amounts that do not meet the definition of costs to be included in calculating the cap.⁴

2.5 Currently, consumer credit legislation in the Australian Capital Territory (ACT), New South Wales (NSW) and Queensland applies a 48 per cent cap that includes interest, fees and charges. Victoria applies a 48 per cent cap, although this does not apply to fees and charges. Caps are not in place in the Northern Territory, South Australia, Tasmania or Western Australia.⁵

The intent of the payday loan provisions

2.6 The basic intent of Schedules 3 and 4 is to mitigate the particular risks associated with short-term credit and thereby enhance consumer protection. Options for a new approach to payday lending were flagged in Treasury's July 2010 Green Paper, 'National Credit Reform: Enhancing confidence and fairness in Australia's credit laws'.⁶

2.7 In November 2009, the federal government introduced the first tranche of its Responsible Lending Obligation reforms. The reforms made it a condition of holding an Australian Credit License (ACL) that lending be done responsibly. Responsible lending has two elements: licensees must assess the unsuitability of a credit product for the consumer and assess the consumer's capacity to repay the proposed credit debt. Compliance with the laws therefore requires an assessment and verification of the consumer's credit needs and financial circumstances. This assessment is conducted by the credit provider when a consumer borrows directly from the provider. All forms of consumer credit are subject to these reforms and it is an offence to supply credit irresponsibly.⁷

4 Explanatory Memorandum, paragraph 5.36, p. 67.

5 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Table: 'Comparison of key features of new law and current law', p. 62.

6 See <http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1852> (accessed 22 November 2011).

7 Senator the Hon. Nick Sherry, 'New National Responsible Lending Laws', *Media Release*, 27 April 2009, <http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/038.htm&pageID=003&min=njs&Year=&DocType> (accessed 22 November 2011).

2.8 Of particular concern for the government is to protect vulnerable consumers from the high cost of payday loans. As the Regulation Impact Statement noted:

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.⁸

2.9 The Assistant Treasurer, the Hon. Bill Shorten MP, described the intent of the bill's short-term loan reforms in terms of balancing consumer protection and industry stability. In his Second Reading Speech on the bill, the Assistant Treasurer noted:

...government strongly believes that short-term loans do have a role in the Australian economy and should be a part of everyday life, but we are also focussed on protecting vulnerable consumers, not terminating the payday lending industry. We do believe it is time that the interests of consumers are improved.⁹

The short term lending industry in Australia

2.10 The PJC's report outlined the key features of the short-term lending industry in Australia. It noted that the industry commenced in the late 1990s in response to ADIs withdrawing from the short-term, small amount loans market.¹⁰ There are currently an estimated 400 payday lenders in Australia and roughly 500 000 clients.¹¹

2.11 The short-term lending industry appears quite diverse. The largest providers are Cash Converters, Cash Stop and The Cash Store.¹² Cash Converters' submission noted that it issues in excess of 625 000 payday loans per year with the total value of loans exceeding \$250 million.¹³ The smaller payday loan providers include Action Cash, Fundco, Action Finance, Moneyplus and Can Do Credit Pty Ltd. Can Do Credit

8 Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Chapter 11: Regulation Impact Statement June 2011, paragraph 11.4.

9 The Hon. Bill Shorten, Assistant Treasurer, Minister for Financial Services and Superannuation, *House of Representatives Hansard*, 21 September 2011, p. 10,952.

10 Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into the Consumer Credit and Corporations Legislative Amendment (Enhancements) Bill 2011, p. 56.

11 Cash Converters, *Submission 20*, Attachment 3, Professor Stephen Corones et al, *Phase two of the national credit reforms examining the regulation of payday lenders*, March 2011, Queensland University of Technology, p. 7.

12 Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into the Consumer Credit and Corporations Legislative Amendment (Enhancements) Bill 2011, pp 56–57.

13 Cash Converters, *Submission 20*, p. 3.

described itself as a 'micro lender', providing roughly 600 loans to 600 customers a year. Its loans are on average '\$1000 for a period of 52 weeks'.¹⁴

2.12 The PJC's report also noted that there is a growing web-based cohort in the payday loan market. These include First Stop Money, Dollars Direct and Cash Doctors.¹⁵

2.13 In terms of repeat lending, the PJC's report noted that industry data 'appeared to support' claims that there is a high proportion of repeat borrowing among consumers who access payday loans. It noted that the estimates of the total number of customers entering into payday loan credit contracts annually are far outweighed by the aggregate of individual lenders' estimates of total loans issued annually. The PJC concluded:

On the basis of this information it would appear that either industry significantly underestimates the number of consumers accessing payday loans per year or there is extensive and substantial repeat borrowing by consumers.¹⁶

2.14 In some detail, the PJC also considered the research evidence on the profile of payday loan borrowers. It noted several sources, including the 2011 report by the Royal Melbourne Institute of Technology (RMIT) and the University of Queensland¹⁷, a 2010 report commissioned by the Consumer Action Law Centre¹⁸ and a 2010 National Australia Bank report on the NAB's Small Loans Pilot.¹⁹ Based on these studies, the PJC noted that a high proportion of borrowers are low income earners, including Centrelink recipients. However, there is an increasing number of middle-income earners accessing the payday loan market.²⁰

14 Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into the Consumer Credit and Corporations Legislative Amendment (Enhancements) Bill 2011, pp 56–57; Can Do Credit Pty Ltd, *Submission 15 to the PJC inquiry*, p. 1.

15 Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into the Consumer Credit and Corporations Legislative Amendment (Enhancements) Bill 2011, p. 114.

16 Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into the Consumer Credit and Corporations Legislative Amendment (Enhancements) Bill 2011, p. 61.

17 Marcus Banks, *Caught Short: Exploring the role of small, short-term loans in the lives of Australians, Interim Report*, RMIT University, August 2011.

18 Zac Gillam and the Consumer Action Law Centre, *Payday loans: Helping hand or quick sand? Examining the growth of high-cost short-term lending in Australian, 2002 -2010*, September 2010, <http://www.consumeraction.org.au/downloads/PayDayLendingReport-FINAL.pdf> (accessed 1 November 2011).

19 National Australia Bank, *Do you really want to hurt me? Exploring the costs of fringe lending – a report on the NAB Small Loans Pilot*, March 2010.

20 Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into the Consumer Credit and Corporations Legislative Amendment (Enhancements) Bill 2011, p. 114.

Support for the provisions

2.15 Consumer advocates, community welfare and religious groups and legal aid organisations are among those strongly in support of Schedules 3 and 4 of the bill. These groups identified the high interest rates of short-term loans as a major problem, particularly for low income borrowers, and an issue that needs addressing. Accordingly, they supported the bill's proposed 48 per cent interest cap and the 10 per cent cap on establishment fees. In addition, several organisations argued that there is a need for greater consumer awareness of the costs of payday loans.

2.16 Legal Aid stated:

Payday lending diverts income. It goes in one hand and straight back out by way of high repayment costs, where there is little or no ability to reduce the balance owing. Who amongst us here could afford a credit card with a 240 per cent interest rate? And yet, without a community norm, that is the very rate that Legal Aid clients in Ipswich were frequently paying before the state cap was implemented in 2008.²¹

2.17 The Consumer Action Law Centre also identified the culprit of very high interest rates as a significant burden on low-income borrowers. In its submission to this inquiry, the Centre stated:

[t]hese loans typically attract effective annual percentage interest rates (APR) of 400 per cent (and can be over 1000 per cent). Moreover, repayments create a very large burden for borrowers on low income, particularly due to the short term nature of many of the loans.²²

2.18 The Centre identified the problem of a debt spiral, with high interest borrowings to finance existing financial difficulties:

In most cases, the high cost, short-term loans are required because individuals have insufficient cash to meet their essential, daily needs (such as utilities, car expenses, food and rent). They are already in financial difficulty. The loan is repaid via direct debit from their bank account at the same time their wages or benefits are credited into the account. Having such a significant amount deducted from their next pay usually leads a borrower to needing another loan within a short period of time to supplement their reduced income.²³

2.19 Similarly, the Redfern Legal Centre identified a similar payday loan borrowing cycle:

21 Ms Catherine Uhr, Senior Solicitor, Legal Aid Queensland, representing National Legal Aid, *Committee Hansard*, Parliamentary Joint Committee on Corporations and Financial Services, 24 October 2011, p. 43.

22 Consumer Action Law Centre, *Submission 8*, pp 3–4.

23 Consumer Action Law Centre, *Submission 8*, pp 3–4.

Many people who enter into short-term, small amount credit contracts...are people on low incomes who are unable to afford to repay their loans even at the time of entering into the contract, and are susceptible to unscrupulous or irresponsible practices of some payday lenders. Such practices can include: credit contracts that do not provide for the due date of payment to coincide with the borrower's payday, providing access to further finance in order to meet repayment obligations, and "rolling over" one payday loan into another. These practices lead to further indebtedness on the part of the borrower and make it unlikely that the borrower will be able to repay their debt.²⁴

2.20 The Legal Centre further submitted that loans with costs above a 48 per cent cap are contrary to prudent market practice:

Where the risk of lending is so high that a consumer loan cannot be granted without charging an interest rate that breaches the 48% cap, we submit that such a loan is irresponsible and predatory, and should not be permissible.²⁵

2.21 Financial Counselling Australia argued in its submission to the committee that the 48 per cent cap should include fees and charges:

Our sector has long advocated for an all inclusive interest rate cap of 48% (including fees and charges) along the lines of that already in place in Queensland, New South Wales and the ACT. This Bill does not go this far, instead proposing a two-tier structure. While this is not our preferred position, we support the legislation as a reasonable compromise.²⁶

2.22 Several organisations noted that consumers are often unaware of the cost of payday loans. Anglicare Sydney, for example, claimed that payday lenders:

...prey on the most vulnerable—people with mental health issues, poor English skills or low levels of financial literacy. We would just like to see, perhaps, a clearer display and disclosure of the actual costs involved with these loans so that people understand, and we would like there to be alternatives provided to them such as microfinance and financial counselling.²⁷

Cap on default charges for small credit contracts

2.23 The PJC's report also noted that the proposed cap on the fee payable in the event of default on a small amount credit contract seems to have general support, even

24 Redfern Legal Centre, *Submission 7*, Attachment 1, p. 6.

25 Redfern Legal Centre, *Submission 7*, Attachment 1, p. 5.

26 Financial Counselling Australia, *Submission 17*, p. 2.

27 Ms Felicia Andersen, Community Care Sustainable Living Coordinator, Anglicare Sydney, *Committee Hansard*, Parliamentary Joint Committee on Corporations and Financial Services, 24 October 2011, pp 67–68.

from payday lenders. Indeed, Money3 questioned whether the proposed default fee cap was sufficiently comprehensive to cover all potential misconduct:

They will get the repayment in a week or a fortnight and then charge an obscene default fee that is not captured under the bill. The only people who will go will be the credible and transparent businesses. I see that as missing that as a major flaw [sic].²⁸

2.24 The PJC concluded that on the basis of the evidence, repayments required under relatively short-term loans 'can constitute a significant proportion of the borrower's income'.²⁹ It emphasised that borrowers must be given a reasonable opportunity to repay credit contracts and that in this context, it may be appropriate to introduce a minimum payday loan contract period (such as three months).

2.25 The PJC also suggested that the government could explore the feasibility of limiting the overall remuneration that a credit provider can receive for issuing a credit contract to which Schedules 3 and 4 apply to 100 per cent of the principal advanced. This would include remuneration obtained by third parties, all costs associated with product add-ons, such as DVDs, and fees payable in the event of default.³⁰

Opposition to the provisions

2.26 Unsurprisingly, several short-term loan providers argued that the proposed amendments would shift the balance too far in favour of consumers to the disadvantage of the industry. Submitters to both this inquiry and the PJC inquiry considered that reforms would render short-term lenders unviable.

2.27 The PJC report identified four main concerns among industry representatives with the proposed measures:

- first, and most fundamentally, they questioned the need for phase two reform to payday lending, arguing that the responsible lending obligations are effectively regulating industry practice;
- second, they challenged the Government's conclusion that the industry can remain viable under the caps proposed;
- third, they argued that the proposed restriction on refinancing, multiple concurrent contracts and increasing existing credit limits will disadvantage, rather than assist, vulnerable consumers; and

28 Mr Robert Bryant, Money 3, *Committee Hansard*, Parliamentary Joint Committee on Corporations and Financial Services, 24 October 2011, p. 22.

29 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Consumer Credit and Corporations Legislative Amendment (Enhancements) Bill 2011*, p. 116.

30 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Consumer Credit and Corporations Legislative Amendment (Enhancements) Bill 2011*, p. 116.

- finally, some advocated for the measures in Schedules 3 and 4 to be extended to apply to ADIs.³¹

2.28 In terms of the first two points above—the need for the reforms and the effect of the reforms on the industry—some payday lenders underlined the commercial importance of only lending to those who can repay their debts. Cash Converters, notably, argued that under the responsible lending requirements (RLOs), consumers' borrowing capacity is adequately assessed to ensure that they are able to properly service their debts. Managing Director Mr Peter Cumins told the PJC at its hearing that:

Again, under the responsible lending obligations you are required to reassess every application. It is not a question of people just coming in and you giving them another \$200. We have to get the bank statements and have to assess the application again on its merit. If you are in the business of lending money unsecured, why would you lend somebody some money if you knew right at the beginning that they could not afford to repay it? It would be a pretty dumb business practice. All of our processes are about identifying how much income a person has available to meet repayments. A customer may come in and ask to borrow \$800 but leaves borrowing \$200 because that is all they can afford to repay. There is no point from a business proposition to lend more than they can afford to repay.³²

2.29 Cash Converters also told the PJC that not only have phase one RLO reforms already imposed a substantial financial burden on the industry, but the phase two reforms threaten to make obsolete those of phase one.³³

2.30 In response, the PJC properly drew attention to the Regulation Impact Statement, which disputes that the RLOs have resulted in significant changes to industry practice:

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.

31 Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into the Consumer Credit and Corporations Legislative Amendment (Enhancements) Bill 2011, chapter 5.

32 Mr Peter Cumins, Managing Director, Cash Converters, *Committee Hansard*, Parliamentary Joint Committee on Corporations and Financial Services, 24 October 2011, p. 53.

33 Cash Converters, *Submission 20*, p. 6; National Financial Services Federation, *Submission 23*, p. 6.

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.³⁴

Restrictions on refinancing and multiple concurrent contracts

2.31 Recall that Schedule 3 of the bill places a restriction on refinancing payday loan contracts and on multiple concurrent payday loan contracts. The PJC report noted the concerns of both Cash Converters and First Stop Money that limiting the number of loans permissible will unfairly restrict consumers' financial capacity, irrespective of their personal circumstances and ability to service the loans.³⁵ First Stop Money's submission to this inquiry argued that:

By providing such a restriction, consumers are excluded from accessing credit, irrespective of their personal circumstances. This directly conflicts with the Bill's purpose and the responsible lending requirements of the existing NCCP Act that decisions should be based upon the consumer's personal circumstances.

A consumer who is more than capable of affording the repayments on two or three small amount credit contracts is therefore prevented from accessing credit which may help them out of short term financial distress thereby snowballing into long term hardship.³⁶

2.32 Mr Paul Baril of the Financiers' Association of Australia, argued that the bill's proposed restriction on recurrent contracts will reduce consumer choice and competition within the industry:

If I go to Cash Stop and my disposable income is \$2,000 and I borrow \$300 – and we do it over three or four payments – and then something breaks down or my car breaks down, I cannot go to another lender and get another

34 *Explanatory Memorandum, Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*, Chapter 11: Regulation Impact Statement June 2011, paragraphs 11.108–11.111.

35 Cash Converters, *Submission 20*, pp 9–10.

36 First Stop Money, *Submission 6*, p. 9.

loan until that loan is paid off. It also reduces competition because the customer will be stuck to stay with the same lender to do the loan.³⁷

2.33 First Stop Money and Cash Converters also raised the possibility that the restrictions on refinancing and multiple concurrent contracts will compel consumers to borrow higher amounts.³⁸ Moneyplus told the PJC that these arrangements may require consumers to take longer loans over longer periods which will lead to a greater incidence of default and indebtedness.³⁹

2.34 The PJC concluded that the proposed restrictions on multiple concurrent contracts, refinancing and increasing credit limits 'did not appear to be an appropriate means of increasing consumer protection'.⁴⁰ It expressed concern at industry views that these provisions may lead to increased financial hardship for consumers. The PJC also noted that the provisions are at odds with the RLOs. It considered that the most appropriate option is to strengthen the operation of the RLOs in relation to payday loans by requiring payday lenders to consider whether the proposed payday loan or increased credit limit is unsuitable given the consumer's repayment obligations under existing credit contracts.⁴¹

Opposition to the proposed caps on credit contracts

2.35 In its hearing on the provision of the bill, the PJC heard various industry concerns of the deleterious effect that the proposed 10 per cent establishment fee and 2 per cent monthly cap for small credit contracts would have on the payday lending industry. Mr Baril from the Financiers' Association told the PJC that the caps are inconsistent with ASIC's requirements that lenders can make a profit.⁴² Money3 also argued that the proposed caps on fees and interest will render the payday lending industry unviable.⁴³ First Stop Money argued in its submission that the 10 per cent fee and the 2 per cent monthly fee are insufficient to recoup costs.⁴⁴ Cash Converters and

37 Mr Paul Baril, Committee Member, Financiers' Association of Australia, *Committee Hansard*, Parliamentary Joint Committee on Corporations and Financial Services, 24 October 2011, p. 20.

38 Cash Converters, *Submission 20*, p. 6. See also First Stop Money, *Submission 6*, p. 9.

39 Mr David Prosser, Chief Executive Officer, Moneyplus, *Committee Hansard*, Parliamentary Joint Committee on Corporations and Financial Services, 24 October 2011, p. 28.

40 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Consumer Credit and Corporations Legislative Amendment (Enhancements) Bill 2011*, p. 115.

41 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Consumer Credit and Corporations Legislative Amendment (Enhancements) Bill 2011*, p. 115.

42 Mr Paul Baril, Committee Member, Financiers' Association of Australia, *Committee Hansard*, Parliamentary Joint Committee on Corporations and Financial Services, 24 October 2011, p. 19.

43 Money 3 Corporation, *Submission 16*, p. 3.

44 First Stop Money, *Submission 6*, p. 13.

Super Nexus both presented data showing the amount that each company is likely to lose per transaction based on its current fee structure.⁴⁵

2.36 The PJC noted that Treasury did not provide details of any economic modelling it used to devise the 10 and 2 per cent caps. Treasury did observe that in developing its model, it did look to 'both allow some upfront costs and also try not to distort the market for very short-term loans by allowing a return over time'.⁴⁶

2.37 The PJC concluded that, on the basis of the evidence before it, the caps will threaten the viability of the payday loan industry. Its assessment was that the evidence strongly indicates that the availability of this type of finance will be significantly reduced, with providers withdrawing from the market and moving to larger amount credit contracts. The PJC recommended that the government should consult further on the level of these caps.

Other options

2.38 Submitters to this inquiry suggested various alternatives to the current provisions in Schedules 3 and 4. Cash Converters, for example, proposed a 20 per cent cap on establishment fees and a 4 per cent monthly fee.⁴⁷ The National Financial Services Federation suggested a 28 per cent cap on establishment fees and a 2 per cent cap on monthly fees.⁴⁸ The Financiers' Association of Australia recommended a 28 per cent cap on establishment fees and a two per cent monthly fee cap.⁴⁹

2.39 Other submitters proposed changes to the 48 per cent cap. The National Financial Services Federation argued that the cap should be removed, and replaced with 'a Permitted Establishment fee and Daily Reducing Interest capped at 48%'.⁵⁰ The Financiers' Association recommended that the formula be modified to avoid 'distortions where there are irregular payment amounts and dates'.⁵¹

2.40 There were also calls for the provisions to be amended to allow caps for lower income earners. First Stop Money suggested a tiered approach to fees and capping whereby for consumers with incomes below the Henderson Poverty Line, an establishment fee of 30 per cent should be charged with a daily reducing interest of 48

45 Super Nexus, *Submission 13*, p. 2; Cash Converters, *Submission 20*, p. 7.

46 Mr Christian Mikula, Manager, Consumer Credit Unit, Retail Investor Division, Department of the Treasury, *Committee Hansard*, Parliamentary Joint Committee on Corporations and Financial Services, 24 October 2011, p. 72.

47 Cash Converters, *Submission 20*, p. 9.

48 National Financial Services Federation, *Submission 23*, p. 9.

49 Mr Baril, *Committee Hansard*, Parliamentary Joint Committee on Corporations and Financial Services, 24 October 2011, p. 20.

50 National Financial Services Federation, *Submission 23*, p. 18.

51 Financiers' Association of Australia, *Submission 40 to the PJC inquiry*, p. 28.

per cent per annum.⁵² Cash Converters proposed a ten per cent and two per cent model as the bill intends, whereby:

Loans to these customers will occur below cost but the trade-off will be that the customers who are better off pay the market rate which effectively subsidises the low income consumer. This is a win-win solution. On the one hand, the Government has genuinely addressed the 'vulnerable' consumer's hardship. On the other hand, industry has a free market to do business with those who do not need the protection of caps.⁵³

Committee view

2.41 The committee notes that the proposed amendments in Schedules 3 and 4 of the bill, as they may affect the payday loan industry, have been the subject of considerable debate in the submissions to this inquiry and in the PJC's deliberations. The strong support of consumer advocacy groups, community welfare and religious organisations and legal aid providers has been offset by the various concerns of the payday loan industry that the reforms will damage its profitability and even its viability. This debate broadly reflects the policy challenge that Treasury faced in devising this legislation: how to adequately protect (often low-income) consumers from the pitfalls of high interest, short-term loans while ensuring that these protections do not distort the commercial viability of the payday loan industry.

2.42 The committee notes the concerns of the PJC that in conducting its inquiry, it lacked adequate evidence from Treasury on:

- the need for the measures in Schedules 3 and 4 in addition to the RLOs;
- how the provisions would interact with the RLOs; and
- why the measures were preferred to other options to protect consumers.⁵⁴

2.43 This committee also notes the lack of substance in the Regulation Impact Statement to the EM relating to these three issues. It draws attention to inadequacies in Treasury officials' verbal evidence to the PJC, particularly on how Treasury sought to model the effect of the proposed caps on the payday loan industry.

2.44 The PJC's report observed that the key question is whether the bill's provisions achieve the right balance between these two imperatives.⁵⁵ This committee makes two observations about the need for the provisions. First, and most

52 First Stop Money, *Submission 6*, p. 15.

53 Cash Converters, *Submission 20*, p. 9.

54 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Consumer Credit and Corporations Legislative Amendment (Enhancements) Bill 2011*, Chapter 5.

55 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Consumer Credit and Corporations Legislative Amendment (Enhancements) Bill 2011*, p. 113.

fundamentally, vulnerable consumers must be protected from the spiralling costs associated with high interest rates and fees from short-term loans. Notwithstanding the increase in the payday loan industry's middle income earning web-based client base, the committee notes that small amount short-term loans do attract significant numbers of consumers in financial hardship on low incomes. The risks of high interest rate loans to these consumers tend to be greater than for other consumers. Further, the rates and fees of many payday loan providers in Australia do seem excessive.

2.45 The second observation is that the national consumer credit reforms are based on the need for nationally consistent legislation to strengthen consumer protection. As mentioned earlier, the ACT, NSW and Queensland already have legislation capping interest rates, fees and charges for short-term small amount loans at 48 per cent. Victoria has legislated a 48 per cent interest rate cap. The committee notes the comments of National Legal Aid to the PJC that there was a fall in the number of clients fronting for assistance after the cap was introduced.⁵⁶

2.46 There is, therefore, a sound and principled case for national legislation to curb excessive interest rates, fees and charges by the payday loan industry in Australia. Like the PJC, however, the committee is concerned that these provisions do not strike the right balance between consumer protection and industry viability. Further, in some cases, there appear to be unintended consequences from the provisions which may hurt consumers. There is also concern that some of the provisions may be ineffectual.

2.47 The PJC's report recommended that the Government revise the measures in Schedules 3 and 4 of the bill with a view to examining these matters. It proposed further consultation with stakeholders 'to develop measures that will ensure cohesive and consistent national consumer credit legislation and an appropriate balance between consumer protection and industry viability'. The committee endorses this view and makes the following recommendation.

Recommendation 2.1

2.48 The committee recommends that the government review the measures proposed in Schedules 3 and 4 of the bill. This review must re-engage with stakeholders to:

- **carefully assess claims that the current provisions may have adverse consequences for consumers;**
- **carefully assess the merit of alternative approaches to focus the provisions on borrowers with low incomes; and**
- **review and publish modelling on the effect of the proposed 10 per cent, 2 per cent and 48 per cent caps on the commercial viability of the payday loan industry.**

56 Ms Catherine Uhr, National Legal Aid, *Committee Hansard*, Parliamentary Joint Committee on Corporations and Financial Services, 24 October 2011, p. 44.

Chapter 3

The bill's other provisions: hardship variations, reverse mortgages, remedies for 'unfair or dishonest conduct' and consumer leases

3.1 As chapter 1 noted, in addition to the 'payday loan' provisions, the Enhancements Bill also has provisions relating to:

- hardship variations to assist borrowers to vary repayments under a credit contract in circumstances of financial hardship;
- reverse mortgages with provisions to assist borrowers to understand the implications of reverse mortgages and changes to the acceptable terms and conditions that may apply to reverse mortgages;
- remedies for 'unfair or dishonest conduct' by creditors in relation to credit contracts, consumer leases and mortgages; and
- consumer leases and measures to align these leases with regulations applying to credit contracts.

This chapter notes the evidence the committee has received on these matters and presents a number of recommendations to strengthen their operation.¹

Hardship variations

3.2 Currently, the National Credit Code (clause 72) provides for borrowers to seek variations of credit contracts less than \$500 000 in circumstances of hardship such as 'illness, unemployment or other reasonable cause'. The variation may take the form of an extended contract period with reduced payments, postponing for a specified period the dates on which payments are due, or extending the period of the contract and postponing for a specified period the dates on which payments are due.

3.3 The Enhancements Bill would extend the circumstances in which hardship variations may be sought. Specifically, the bill would:

- enable all borrowers to apply for hardship variations, regardless of the contract value;
- allow that the hardship notice may be made orally or in writing;
- not impose limits to the form of hardship variation that the borrower may request;

1 The recommendations in this chapter are broadly the same as those proposed in the report by the Parliamentary Joint Committee on Corporations and Financial Services.

- exempt the borrower from stating the reasons why he or she is unable to meet the repayment obligations;²
- exempt the borrower from demonstrating that he or she could meet the changed repayment obligations; and
- require the credit provider—within 21 days of receiving the request for variation—to notify the borrower that they are prepared to negotiate a contract variation or are refusing the request. If the provider is refusing the request, he or she must provide reasons and details of an approved dispute resolution scheme.

3.4 Anglicare Victoria and Good Shepherd Youth and Family Services supported these provisions to protect debtors in circumstances of hardship and to make it easier to apply for hardship variations.³ The ANZ noted its support for the government's intention to 'make it as easy as possible for customers to apply for hardship assistance'.⁴

3.5 However, various lending organisations expressed concern with aspects of how these provisions would operate. The Credit Ombudsman Service argued that it would be 'extremely useful, if not critical' to retain a requirement that the borrower must demonstrate that he or she can meet the changed repayment obligations.⁵ GE Capital argued along similar lines.⁶

3.6 Abacus⁷ and the Australian Bankers' Association (ABA) argued that the 21 day timeframe should not commence before the credit provider receives sufficient information to assess the application.⁸ ANZ also supported this proposal noting that the trigger of a 21 day response time commencing immediately upon verbal notification from a customer rather than once sufficient information has been provided:

...is of particular concern in the context of a joint mortgage and where there has been a breakdown in the relationship between the borrowers...In the case of a joint loan, the refusal of one party to provide information can

2 The bill does not expressly state that in order to apply for the contract to be varied, the borrower's capacity to repay must be affected by hardship.

3 Anglicare Victoria, *Submission 39 to the PJC inquiry*, p. 2; Good Shepherd Youth and Family Service, *Submission 23 to the PJC inquiry*, p. 3.

4 ANZ, *Submission 10*, p. 2.

5 Credit Ombudsman Service, *Submission 2 to PJC inquiry*, p. 2.

6 GE Capital Australia and New Zealand, *Submission 26*, p. 2.

7 Abacus is the industry body representing the Australian mutual sector.

8 Mr Ian Gilbert, Policy Director, Australian Bankers' Association, *Committee Hansard*, Parliamentary Joint Committee on Corporations and Financial Services, 24 October 2011, pp 12–13; Abacus, *Submission 9*, p. 3.

impede our ability to assess both or one of the borrowers for hardship assistance.⁹

3.7 The committee believes that the bill should require borrowers to provide the necessary documentation regarding the kind of hardship variation they are seeking and their capacity to repay.

Recommendation 3.1

3.8 The committee recommends that clause 72 of the National Credit Code be amended to require borrowers to provide reasonable information to assist credit providers to assess their application and to give credit providers reasonable opportunity to seek this information from the borrower where it is not initially provided.

Verbal notification

3.9 Various industry submissions expressed concern that the bill's permission of a verbal notice (rather than a written application) would lead to misunderstandings between the credit provider and the borrower. The ABA, notably, put the following argument to the PJC:

We understand that the oral or in writing hardship note a customer can give is to reduce barriers to access to the hardship teams that our members have. But if someone rings up and is unclear about what it is they are actually seeking then the whole process of getting a better understanding of it is very awkward. It could be just a chance comment in a branch or it could be a chance comment over a telephone that someone does not recognise is someone saying, 'I don't think I'm going to meet my obligations under the credit contract.' If that is not acted upon, inadvertently that triggers a 21-day notice requirement, with a criminal penalty at the end of it if you do not comply...[T]here are problems and we understand the problems with an oral-only notice. Our preference would be for something in writing. In our chart that we have provided to the committee we have suggested that there be some formality around the provision of information by the customer and that the clock should not start ticking until such time as a reasonable level of information has been obtained from the customer. That works well for both parties, bank and customer.¹⁰

3.10 Both the ABA and the Australian Finance Conference argued that the option for hardship variations to be made verbally should be removed from the bill. The committee agrees: to avoid misunderstanding, this provision should be removed from the bill to ensure that applications are made in writing.¹¹ In addition, the government

9 ANZ, *Submission 10*, p. 3.

10 Mr Ian Gilbert, Policy Director, ABA, *Committee Hansard*, Parliamentary Joint Committee on Corporations and Financial Services, 24 October 2011, p. 13.

11 Australian Finance Conference, *Supplementary submission 25*, p. 3.

should ensure that there is publicly available information to advise borrowers of their rights and obligations in relation to hardship variations.

Recommendation 3.2

3.11 The committee recommends that 'orally' be removed from subclause 72(1) to require hardship applications to be made in writing.

Recommendation 3.3

3.12 The committee recommends that the government work with industry stakeholders to develop a plain English, user-friendly information pack about borrowers' rights and obligations in relation to hardship variations. The government and industry should consider including a link to the information on the MoneySmart website about financial counselling assistance. Industry should be required to provide a copy of this information pack on their websites and at customer service centres.

Reverse mortgages

3.13 A reverse mortgage is a facility enabling a home owner to take equity out of their home either as a regular ongoing cash payment or a lump sum, or a combination of both. It is a way that home owners can access funds for their retirement and without a credit check given that the borrower does not need to make any payments. The home must be sold to repay the mortgage when the borrower dies.¹²

3.14 Currently, reverse mortgages are regulated under the NCCP Act and subject to the same provisions as all other credit contracts. The Redfern Legal Centre noted in its submission to this inquiry that there are no additional responsible lending conduct obligations or requirements in relation to reverse mortgages.¹³ The Centre also observed that there are no disclosure requirements specific to reverse mortgages nor any maximum limits on a borrower's liability in relation to a debt.¹⁴

3.15 The bill proposes a number of changes to reverse mortgages:

- introduce a 'no negative equity guarantee' to prohibit credit providers from requiring or accepting loan repayments exceeding the market value of the property (subject to certain exceptions);
- require borrowers to receive legal advice before entering into a reverse mortgage contract;
- require credit providers to disclose the way the reverse mortgage would apply to non-title holding occupants;

12 See Investopedia, <http://www.investopedia.com/terms/r/reversemortgage.asp#axzz1f8o9xfZA> (accessed 30 November 2011).

13 Redfern Legal Centre, *Submission 7*, p. 7.

14 Redfern Legal Centre, *Submission 7*, p. 7.

- require credit providers to attempt to contact borrowers in person where the reverse mortgage is in default; and
- exclude the following circumstances from constituting default under the loan:
 - the borrower failing to inform the credit provider that another person occupies the property;
 - the borrower failing to provide the credit provider evidence of who lives at the property;
 - the borrower leaving the property unoccupied while the property was the borrower's principal place of residence;
 - the borrower failing to pay a cost to a person other than the credit provider (for example, rates);
 - the borrower failing to comply with a provision of the credit contract, if the credit contract is unclear about what is required; and
 - the borrower breaching another credit contract with the credit provider.

3.16 In addition, the bill would introduce a requirement that credit providers give borrowers: an equity projection calculated through an ASIC-approved website; a reverse mortgage information statement; and a notification of additional information to assist the borrower whether or not to enter into a reverse mortgage contract.

3.17 The PJC report raised four issues of concern relating to the bill's provisions on reverse mortgages:

- the obligation to provide equity projections;
- the circumstances constituting default;
- repayments; and
- the definition of reverse mortgages.

The obligation to provide equity projections

3.18 Consumer advocates and industry representatives were broadly supportive of these changes. There were, however, some concerns with technical aspects of the bill's provisions on reverse mortgages. SEQUAL and Australian Seniors Finance raised concerns in their submissions to the PJC that a 'face to face' meeting to show borrowers an equity projection may not always be practical.¹⁵

3.19 The committee believes that it is important that there are separate regulations governing reverse mortgages. This noted, the committee agrees with the PJC that there should be some flexibility in the method of providing projections. The key is that the

15 SEQUAL, *Submission 44*, Parliamentary Joint Committee on Corporations and Financial Services, p. 13. Australian Seniors Finance, Mrs Julie Campbell, *Committee Hansard*, Parliamentary Joint Committee on Corporations and Financial Services, 24 October 2011, p. 4.

credit provider must ensure that the borrower receives and understands the projection before the reverse mortgage contract is entered into.

Recommendation 3.4

3.20 The committee recommends that clause 133DB be amended such that the credit provider is not restricted in the method of providing projections. The clause should require credit providers to ensure that a potential borrower receives and understands the projections before entering into a reverse mortgage contract.

Circumstances constituting default

3.21 SEQUAL and ASF also expressed concern with subclause 18(3) of the bill which excludes certain circumstances for the factors that constitute default under a reverse mortgage. They noted that as the bill is drafted, the following circumstances would not constitute default:

- failure on the part of the borrower to inform the credit provider of changes in occupancy;
- failure by the borrower to pay costs to third parties (such as rates); and
- the property being left unoccupied.

3.22 The ASF argued that failure to notify the lender of changes to occupancy means that a client might not reside in the home for years, raising a negative equity issue for the provider.¹⁶ Similarly, SEQUAL noted that removing the requirement of borrowers to inform lenders that they no longer occupy the property is 'in contradiction to the essence of the trigger for repayment of Reverse Mortgages'.¹⁷

3.23 SEQUAL recommended that to address these concerns, the exception for failure to meet third-party costs such as rates could be 'limited to a reasonable period of time of rate non-repayments'. Further, it suggested that the clause be amended 'so that default only occurs if the property is left vacant without the lender's approval for a reasonable period of time provided that at all times that period of vacancy does not otherwise cause a fault (e.g. Valid property insurance cover etc.)'.¹⁸ The committee agrees that clause 18A of the bill should be clarified to provide protection for credit providers.

16 Mrs Julie Campbell, Australian Seniors Finance, *Committee Hansard*, Parliamentary Joint Committee on Corporations and Financial Services, 24 October 2011, p. 2.

17 SEQUAL, *Submission 44*, p. 14.

18 SEQUAL, *Submission 44*, p. 14.

Recommendation 3.5

3.24 The committee recommends that government consult with industry to ensure that clause 18A only excludes matters that are of a minor nature and that do not pose a measurable risk to the credit provider's interests.

Repayments

3.25 Clause 86A of the bill would allow borrowers to end the reverse mortgage at any time by paying the market value of the property. Some submitters noted that this provision could lead to borrowers 'playing the market' to avoid repaying the entire amount owing. SEQUAL advocated for safeguards to be introduced to mitigate the risk that borrowers would 'play the field' to avoid repaying the entire amount owing.¹⁹

3.25 The committee agrees that it is important that safeguards are in place to ensure that the 'no negative equity guarantee' does not provide the opportunity for borrowers to 'play the field'.

Recommendation 3.6

3.26 The committee recommends that Subdivision B, Division 1, Schedule 2 be amended to ensure that sales, particularly between related parties, stand the market test of fair market value.

Clarifying the definition of reverse mortgages

3.27 The other issue relating to the bill's reverse mortgage provisions is the bill's definition of a reverse mortgage. The Australian Banker's Association expressed concern that the definition would encompass forms of lending that are not intended to operate as reverse mortgages, including overdrafts and lines of credit. The committee endorses the following recommendation made by the PJC.

Recommendation 3.7

3.28 The committee recommends that the definition of reverse mortgages at item 2 of Schedule 2 be amended to clearly exclude other forms of credit arrangements that provide the option of interest only repayments.

Remedies for unfair or dishonest conduct

3.29 Part 2, Schedule 1 of the bill introduces a new category of conduct for which consumers may seek civil remedies: 'unfair or dishonest conduct by credit providers' (clause 180A). This conduct is based on the circumstances of the consumer credit transaction, and where one or more of the following factors are at play, the court must consider it likely that the conduct was unfair or dishonest:

19 Mr Kevin Conlon, SEQUAL, *Committee Hansard*, Parliamentary Joint Committee on Corporations and Financial Services, 24 October 2011, p. 11.

- the consumer was at a special disadvantage;
- the consumer was a member of a class of persons whose members are more likely to be at a special disadvantage;
- a reasonable person would consider that the conduct was directed at the class of persons more likely to be at a special disadvantage and of which the consumer was a member;
- the consumer was unable, or considered themselves to be unable, to enter into a credit contract, mortgage or consumer lease; or
- the terms of the contract were less favourable than the consumer could have obtained from another provider.

3.30 In terms of the credit provider, the relevant circumstances are:

- whether the credit provider could determine, or significantly influence the contract terms;
- whether the credit provider's conduct involved a technique that should not in good conscience have been used or manipulated the consumer.

3.31 Various submitters supported the introduction of remedies for 'unfair and dishonest conduct' by credit providers, including Aussie²⁰, the Consumer Action Law Centre²¹, the Consumer Credit Legal Centre (NSW) Inc.²² and Good Shepherd Youth and Family Services²³.

3.32 The Consumer Action Law Centre, for example, argued that these provisions may give greater protection for consumers who may find it difficult to prove unconscionability under the *Australian Securities and Investments Act 2001*. However, the Centre did recommend that clause 180A should be amended to focus on the consumer's 'special disadvantage' and should be replaced with the broader term 'disadvantage'.²⁴ Good Shepherd Youth and Family Services also proposed amending this requirement of 'special disadvantage', proposing instead that the court establish that the dishonest conduct 'led to the taking of the financial product'.²⁵ In its submission, the ANZ commented that any finding of unfairness or dishonesty 'should

20 Aussie, *Submission 10 to PJC on Corporations and Financial Services*, p. 3.

21 Consumer Action Law Centre, *Submission 8*, p. 16.

22 Consumer Credit Legal Centre (NSW) Inc., *Submission 24*, p. 12.

23 Good Shepherd Youth and Family Services, *Submission 23 to PJC on Corporations and Financial Services*, p. 4.

24 Consumer Action Law Centre, *Submission 8*, pp 17–18.

25 Good Shepherd Youth and Family Services, *Submission 23 to PJC on Corporations and Financial Services*, p. 5.

be based on the nature of the actual conduct engaged in by the defendant, rather than on the consumer's particular circumstances'.²⁶

3.33 The committee believes that proposed clause 180A should require a causal nexus between the credit provider's conduct and the harm suffered by the consumer. Reference only to the borrower's circumstances, without reference to the credit provider's knowledge of those circumstances, could create a disincentive for credit providers to lend to disadvantaged persons.²⁷

Recommendation 3.8

3.34 The committee recommends that clause 180A be amended to require a court to find that the credit provider was aware of, and sought to take advantage of, the consumer's 'special disadvantage'.

Recommendation 3.9

3.35 The committee recommends that the circumstances that may constitute unfair or dishonest conduct at paragraph 180(3)(f)–(g) be amended to only apply where the credit provider is aware of the borrower's special advantage and seeks to exploit this.

Consumer leases

3.36 A consumer lease is a contract for the hire of goods under which the lessee does not have a right or obligation to purchase those goods. Currently, the National Credit Code only partially covers consumer leases: it does not provide protections to parties for consumer leases that do not provide an option to purchase, or to leases that do not require the consumer to pay more than the cash price of the goods. The Explanatory Memorandum notes that this situation—with some leases covered by the Credit Code and others not—can lead to a situation where lessees mistakenly believe they have the ability to buy the goods.²⁸

3.37 Schedule 5 of the bill proposes to align the regulation of consumer leases with the regulations applying to credit contracts under the *National Consumer Credit Protection Act 2009* and the National Credit Code. Most submitters who commented on the Schedule noted their support for providing lessees under consumer leases with the same protections as debtors under credit contracts. The Redfern Legal Centre, for example, argued that 'addressing this gap in consumer credit laws is important to prevent unscrupulous industry participants from taking advantage of the loophole in

26 ANZ, *Submission 10*, p. 4.

27 See PJC on Corporations and Financial Services, Report on the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011, Chapter 6.

28 Explanatory Memorandum, paragraph 6.9.

order to bypass their obligations under the Act'.²⁹ In its submission, the Centre gave the following example of where this unscrupulous activity currently occurs.

Lauren is a mother of five. When her car broke down, Lauren went to a well-known car dealership to buy a second hand car. After speaking with the sales representative, Lauren signed a contract and drove off with a second hand vehicle. Lauren soon ran into difficulties meeting her repayments. She came to Redfern Legal Centre for advice. Lauren was shocked to learn that she had in fact signed a consumer lease, and that at the end of the lease she would not own her vehicle. This had not been made clear to her when she went to the dealership with the intention of buying a car.³⁰

3.38 The Consumer Action Law Centre and the Consumer Credit Legal Centre (NSW) Inc. argued that the regulations under clause 175D must require periodic statements of account to include a clause drawing the lessee's attention to the fact that the goods remain the property of the lessor at the end of the lease. As the Consumer Action Law Centre noted:

[o]ne of the most common complaints we hear from consumers regarding consumer leases is that they were misled or otherwise unaware that had entered into a consumer lease (rather than a credit contract) and that they would not own the goods at the end of the lease term.³¹

3.39 The committee agrees that, in addition to the provisions in Schedule 5 of the bill which align the protections of consumer leases with those of credit contracts, there is a need to inform consumers in cases where a consumer lease does not transfer title to the lessee.

Recommendation 3.10

3.40 The committee recommends that the regulations under Part 2, Division 2, clause 175D of the *National Consumer Credit Protection Act 2009* require the statement of account to contain a clear statement that the lessee will not own the good at the completion of the lease.

Senator Mark Bishop
Chair

29 Redfern Legal Centre, *Submission 7*, p. 9.

30 Redfern Legal Centre, *Submission 7*, p. 9.

31 Consumer Action Law Centre, *Submission 8*, p. 15.

Additional Comments by Coalition Senators

1.1 Coalition Senators make the following additional comments concerning the Committee's inquiry into the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011.

1.2 Coalition Senators fully endorse Recommendation 12 made by the Parliamentary Joint Committee on Corporations and Financial Services that:

the Government revisit the measures proposed in Schedules 3 and 4 of the Bill and Enhancements Bill. Further consultation with stakeholders should be undertaken to address the concerns identified throughout the inquiry and to develop measures that will ensure cohesive and consistent national consumer credit legislation and an appropriate balance between consumer protection and industry viability.¹

1.3 The Committee received evidence that the payday lending industry is meeting significant consumer demand for short term, small amount (STSA) loans. One lender, Money 3, provided evidence in its submission to the Committee that the industry provides cash advances totalling \$800 million and serves 500,000 customers annually.²

1.4 Accordingly, Coalition Senators are of the view that consideration of any regulatory restrictions on STSA loans must take into account the potential detriment to consumers of further restricting the availability of a financial product for which there is proven and consistent demand.

1.5 When Minister Bill Shorten announced the measures in the Bill he stated in his media release that these measures were intended to 'protect ... vulnerable consumers'.³ This statement suggests that the Bill is based on an assumption that all STSA loans are inherently harmful and that all consumers who access such loans are inherently vulnerable to the extent that they require special government protection. Based on the evidence presented to the Committee, Coalition Senators do not think that is a correct assumption for the government to make.

1.6 Coalition Senators acknowledge the important, challenging and sometimes confronting work that is performed by consumer legal services and financial counsellors throughout Australia. But we do not agree with the contention that all STSA loans are inherently dangerous and that the provision of such loans should be tightly restricted, or even prohibited.

1 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*, December 2011, p. 118.

2 Money 3, Submission 16, p. 2.

3 Bill Shorten, Media Release, 25 August 2011, '*Reforms to Payday Lending*'.

1.7 Coalition Senators acknowledge that there are some people whose ability to make sensible financial decisions is impacted and impaired by various factors including addiction, substance abuse, and other limitations.

1.8 However the Committee received persuasive evidence that many STSA loans are provided to people who are in employment and who have made a rational and balanced decision that an STSA loan is the most appropriate financial solution in their own individual circumstances.

1.9 In fact, submissions made to the Committee and to the PJC from lenders such as Money Plus, Money Centre, Dollars Direct, Cash Doctors and First Stop Money indicated that many STSA loan providers had specific requirements that borrowers must be employed or had rules that did not enable them to lend money to people who relied solely on government benefits.⁴

1.10 The evidence provided to the Committee highlighted several serious concerns about the approach taken by the government in the Bill.

1.11 Coalition Senators are concerned that this Bill is not based on a thorough process which adequately considered the legitimate policy concerns about the current regulatory framework in relation to STSA loans, but was rather more focused on the perceived short term political objective of being seen to be doing something.

1.12 We are of the view that if this Bill is passed in its present form it would cause serious damage to the market for the provision of STSA loans. In particular, the proposed caps on fees and charges would make existing STSA business models unsustainable.

1.13 The Australian Bankers Association submitted to the Committee that in this Bill the government had adopted the flawed and simplistic 48 per cent cap that had been introduced by the former NSW Labor government without any consultation with industry whatsoever prior to its introduction:

The proposed model for calculation of the “cost rate” is based on a model legislated under the Credit (Commonwealth Powers) Act 2010 (NSW) upon which there was no prior consultation with the credit industry. Subsequent representations to the New South Wales government were to no avail.⁵

1.14 This 48 per cent cap means that almost any loan for a short term would likely be unviable for a provider based on a cap that is calculated on an annualised rate. For example, on a loan of \$100 for a two week period the cap would be breached by any fee greater than \$1.85. Therefore, the cap would make the provision of short term loans practically impossible, which highlights the inherent flaw in the proposed 48 per

4 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*, December 2011, paragraphs 5.72-5.76.

5 Australian Bankers' Association, *Submission 18*, p. 16.

cent cap. This 48 per cent cap is proposed to apply to all loans other than ‘small amount credit contracts’.

1.15 The Bill proposes a separate cap for ‘small amount credit contracts’ which are defined as contracts for less than 2 years and for less than \$2,000. The cap for these types of contracts would be an upfront fee of 10 per cent of the principal amount and a monthly fee of 2 per cent.

1.16 Coalition Senators were concerned to note comments made by the PJC in its report that Treasury officials were not able to provide details of any economic modelling that supported or underpinned the development of the ‘10/2’ fee structure.⁶

1.17 Additionally, no evidence has been provided to indicate that any assessment or modelling has been conducted by Treasury or the government to determine the impact of this proposed ‘10/2’ fee structure on the ongoing viability of STSA loan providers.

1.18 Coalition Senators are concerned that if the provisions of this Bill lead to STSA loans by private sector providers becoming uneconomic that there will be few viable alternatives for the provision of such loans to satisfy existing demand for such loans by consumers.

1.19 Although the Minister’s media release did identify some alternatives, there was no evidence provided that such alternatives would be available in sufficient volume or in a timely manner to meet consumer demand.

1.20 Coalition Senators are also concerned that the Bill specifically does not apply to Authorised Deposit-taking Institutions (ADIs) such as banks and credit unions. Competitive neutrality should be a core public policy principle that underpins legislation, especially in the provision of financial services so as not to discriminate between market participants. By exempting ADIs from the provisions of this Bill the government has transgressed the principles of competitive neutrality and discriminated against one sector of the financial services industry, being the providers of STSA loans.

1.21 STSA lenders submitted to the Committee that they are already prevented from making loans to customers who will be incapable of repaying them by the existing responsible lending framework which was introduced by the *National Consumer Credit Protection Act 2009* and which applies to all lenders in Australia including ADIs and STSA lenders.

1.22 No evidence has been provided by the government to indicate that this responsible lending framework fails in any way to provide sufficient regulatory

6 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011*, December 2011, paragraphs 5.180.

oversight and consumer protection in the provision of STSA loans, including protection for disadvantaged and vulnerable consumers.

1.23 Coalition Senators believe that a full examination of the application and suitability of the existing responsible lending framework to STSA loans should be conducted prior to the introduction of the highly prescriptive and potentially crippling provisions contained in this Bill.

1.24 Other measures in the Bill contain some highly detailed and prescriptive interventions in existing business practices including restrictions on multiple concurrent contracts and on increasing credit when an existing loan matures.

1.25 Coalition Senators believe that the principle of such prescriptive interference is undesirable and that the measures introduced by this Bill will be unworkable in practice.

1.26 We are unconvinced that the proposal to set a cap on prices that STSA loan providers are able to charge is appropriate. Whilst we support full disclosure of fees and charges and a requirement to disclose annualised rates to customers using standardised methodology. The Coalition is sceptical about the desirability to cap prices without an evidence-based approach which has fully assessed the impact of such proposed caps on both business and consumers.

1.27 Coalition Senators recommend that the Productivity Commission (or a similar independent body) would be the most suitable body to undertake a comprehensive evidence-based study to determine:

- (a) whether the existing responsible lending framework is appropriate for the regulation of STSA loans or whether alternative regulation is required;
- (b) to assess the impact on the business models of STSA lenders of various alternative pricing models; and
- (c) the best model to ensure the appropriate balance between the ongoing capacity of STSA loan providers to respond to consumer demand for these types of loans and appropriate levels of consumer protection.

1.28 If the government is serious about achieving reforms that strike the right balance between consumer protection and the industry's capacity to meet legitimate consumer demand for these products and services, as recommended by the PJC, it would reconsider its current proposals and develop a better considered evidence-based policy approach.

Senator David Bushby
Deputy Chair

APPENDIX 1

Submissions Received

Submission Number	Submitter
1	QBE Insurance Group Limited
2	Muru Mittigar Aboriginal Cultural and Education Centre
3	UCFS Australia Pty Ltd
4	Australian Institute of Company Directors
5	The Cash Store Australia
6	First Stop Money Limited
7	Redfern Legal Centre
8	Consumer Action Law Centre
	<ul style="list-style-type: none">• Supplementary submission
9	Abacus – Australian Mutuals
10	ANZ
11	DollarsDirect
12	Direct Selling Association of Australia
13	Super Nexus Pty Ltd
14	Tony Davis and Associates
15	Confidential
16	Money3 Corporation Limited
17	Financial Counselling Australia
18	Australian Bankers' Association Inc.
19	A Better Chance Pty Ltd
20	Cash Converters Pty Ltd
21	Cash Doctors
22	Confidential

23	National Financial Services Federation Ltd
	• Supplementary submission
24	Consumer Credit Legal Centre (NSW) Inc
25	Australian Finance Conference
	• Supplementary submission
26	GE Capital Australia and New Zealand
27	Chartered Secretaries Australia Ltd
28	Veritec Solutions
29	CHOICE
30	Fast Access Finance Pty Ltd
31	Min-it Software
32	Dr Therese Wilson, Griffith Law School
33	Financiers' Association of Australia/Industry/Smiles Turner Delegation