SECTION 7
Consumer Advocates Misguided

When commenting on annualised percentage interest rates (APRs) in regard to the cost of the loan to the consumer, the use of direct debits, types of securities taken, repeat loans (rollovers) and consumers having two or more loans at the one time, consumer advocates have demonstrated that they have allowed their idealism to blind them to the realities of these issues.

The Delegation is concerned to present an industry perspective in regard to these issues.

Consumer Advocates and APRs

The current Bill has perpetuated the APR myth by providing for a maximum "*annual cost rate*" at Section 32A(1) and, at Section 32B, largely adopting the model currently in force in NSW.

In doing so, the proposed provisions reflect the National Credit Code's requirement in Section 157 and following, that a comparison rate be calculated that "*will reflect the total cost of credit arising from interest charges and other prescribed credit fees and charges*".

The Act then goes on to make it clear that the intention is that comparison rates will be used at least in all relevant advertising. This creates conflict within the Code itself because, as it does not reflect the "*true*" cost, it is a "...*false or misleading representation in relation to a matter that is material to entry into a credit contract...*" - Section 154(1).

The Delegation considers that the comparison rate apparatus is, in fact, "*a nominal rate per annum*", as used to describe the calculation of the maximum annual percentage rate in Section 7 of the NSW legislation, Credit (Commonwealth Powers) Act 2010. It is "*nominal*" as, in the minds of the consumers, it is irrelevant. This is because their analysis of the cost of credit is very different (as discussed below).

Because of this, the objectives mentioned in Section 157(1) of the Code, "*The object of* (comparison rates) *is to assist consumers to identify the true cost of credit offered by credit providers*" is not achieved. This is particularly so because the comparison rates associated with small amount, short term lenders are constantly compared to the interest rate charged by a bank.

Unfortunately, the consumer advocates frequently attempt such a comparison, directly or by implication, without any attempt to mention that, on top of these interest rates banks also have fees and charges.

In addition, the opportunity to effectively misrepresent is constantly accepted by consumer advocates, who conveniently fail to recognise that the fundamental problem with the use of annualised percentage rates (APRs), is that an APR implies a loan that runs for a full 12 month term.

What consumer advocates fail to do is to recognise that most small amount, short term loans have terms nowhere near 12 months. As a result, the statement of a figure as an annual rate is very misleading because, unless the loan term is for the full 12 months, it emphasises a cost that is not, in fact, paid by the consumer.

The current Bill's inclusion of a 48% cap compounds this misuse.

Money and the meat market

Just like meat, money is a product.

The financial progress of meat from grazier to consumer is no different to a bundle of money being sold for a specific period. A butcher taking 14 days or 30 days to sell the meat is the equivalent of a lender being repaid in 14 or 30 days.

Amount to grazier	Amount to butcher	Return to butcher	14 day APR	30 Day APR
Lamb - $65.50	$182.50	278.63%	7,264.28%	2,825%
Beef - $660.00	$2,000.00	294.12% -357.14%	9,311.15%	3,621%

One week loan -

The practical, as opposed to theoretic, realities of an APR are demonstrated in the table below. $100 borrowed for 1 week, presents the following APRs:

Fee	APR
$ 0.92	48%
$ 2.50	130%
$ 5.00	260%
$ 7.50	390%
$ 10.00	520%
$ 15.00	780%
$ 20.00	1,040%

Smiles Turner research and industry analysis repeatedly presents that the consumer is only interested in the fact that it will cost them a $20 fee to cover the $100 loan.

However, the consumer advocates and headline hungry media are only interested in quoting the misleading 1,040% "interest rate" (APR), implying that the lender is making a fortune and robbing the consumer. As the Committee will recall from the previous Section, a $20 fee does not even cover the cost of the time taken for the staff to administer the loan.

Comparing a bank overdrawn account fee

It is interesting to note the following APRs in association with a standard $35 fee charged by the banks for an overdrawn account.

Where an account is overdrawn by $200 for one week, and an overdraw fee of $35 (standard) is charged by the bank - the annualised percentage rate is 910%.

Where the overdrawn amount is $100 - for one day - the annualised percentage rate associated with being charged the $35 fee is 12,775%.

Where the amount is $1 - for only 1 day - the annualised percentage rate on the $35 fee is 1,277,500%.

Borrowing for car repairs - unintended consequences

The owner needs $100 to buy some spare parts and he has spent all his money for that week. He borrows $100 for 1 week and repays $120 at the end of the week.

That $20 is the equivalent of an interest rate of 1,040%.

He does not qualify for any of the alternative schemes.

He attempts to borrow the $100 under a 48% regime - no lender will help, because the amount the car owner will have to pay in interest is 92 cents. The consumer's decision to pay "an additional" $19.08 to get his car on the road again, so that he can get to work on time, is a choice he has a right to make.

Consumers' understanding of APRs

The 276 lending outlets and offices across Australia participating in the April 2006 Smiles Turner lender survey, in response to the question, "*What percentage of your customers do you think understand what a comparison rate is*?", revealed the following:

No. of customers' understanding APRs	% of outlets
Nil	65%
1% or less	33%
10%	0.4%
20%	0.4%
Unsure	1%

A second question was asked, "*How difficult is it for you to explain to a customer what a comparison rate is?*":

Difficulty level	% of outlets
Extremely/very confusing	57%
Customers never ask	36%
Not difficult/fairly easy	4.4%

A third question was then asked, "*For those customers who do not use comparison rates as part of the decision-making process to borrow from you, what alternative information do they use as their PRIMARY information on which to base their decision?*"

100% replied - "*Repayment amounts*".

3 month loan

The following provides yet another example as to why the idealism of using an artificial contrivance called an APR does not the match the reality of the transaction.

A loan with principal of $1,165, borrowed for 12 weeks, with an application fee of $116, plus a total of account keeping and direct debt charges, repaid at a weekly rate of $123.50, plus 29.95% daily reducing interest totalling $46.48 - all up $285.48.

Percentage of total repayments that constitutes all fees and interest - 19.7%.

Comparison rate - 193.94%.

Total fee - calculated as above - only at 48% - if it was possible to break even on the loan (which it is not) - $76.44.

Use of Direct Debits

The consumer advocates maintain that direct debits guarantee repayment to lenders and that, by implication, it ensures lenders are repaid, while the borrowers are frequently left with not even enough money to buy food for the coming week.

The Delegation believes that this simplistic assessment is flawed, because it fails to recognise the realities of the direct debit process and because it overlooks an essential element associated with responsible lending, that could provide easy grounds for prosecution of an offending lender.

By way of introduction to this topic, the Delegation notes that, when lenders were asked in November 2010, "*Have you ever been able to ensure that your repayment is prioritised as first to be debited by the bank when they process direct debits*", 97.4% replied "*no*".

Direct Debits and "Secure" Loans

The Delegation does not deny the almost universal use of direct debits to facilitate payment by the small amount, short term finance sector. In the Smiles Turner 2010 and 2011 research, only 5 lenders indicated that they did not use direct debits to facilitate repayment. All specialised in loans predominantly over $4,000.

The Delegation thinks it is important to emphasise that Centrelink itself operates Centrepay, which is a direct debit facility.

It must first be emphasised that this method of arranging payments is used by many companies dealing with a fee paying public.

Insurance companies use direct debits for their periodic premiums, real estate agents for rent, gyms with their "membership" fees, Telco's for their phone bills, utility companies for gas and electricity payments, charities for regular donations, banks for the repayment of their mortgages, and many, many others.

Every lender using direct debits reports defaulting consumers. Logically, if there are defaults associated with consumers who repay by direct debit, then direct debits do not guarantee repayment.

27 lenders on the Smiles Turner October 2011 research panel, all of whom offer the option of direct debit for repayments, provided the following information regarding general advantages:

1. They are set so that they automatically stop when repayment has been achieved.
2. It is not expensive for the consumer.
3. You do not have to attend the bank to arrange it.
4. Unlike direct deposits, a consumer with a computer is not required.
5. It avoids consumers having to go to a bank branch to pay.
6. It avoids the need for people to attend in person to pay the entity.
7. It means lenders do not keep cash on their premises and become a robbery target.
8. Administratively, it is a cheap way of facilitating payment, saving staff time and keeping the loan price down.

The central characteristic of a direct debit facility is that it is no more secure than a post-dated cheque. It fails (or bounces) if there are insufficient funds in the account. In addition, there are a number of other attributes that do not support the consumer advocates' assessment:

- It can be cancelled at any time by the consumer, simply by that consumer contacting the relevant bank.
- Consumers can nominate the day a direct debit is paid and that does not have to be the day they are paid.
- Banks do not provide certainty as to when the direct debit will be processed. That means the consumer can withdraw all the money in the account on the day prior to the processing, so that the direct debit "bounces" or defaults. Note the NAB, CBA and ANZ all process at 11.30 pm, so the consumer has 12 hours to take the money out of their account before the payday loan costs hit.
- Unscrupulous customers know when their direct debit is due and, to avoid paying the debt, they clear the account prior to that time.
- This is particularly relevant for Centrelink benefit recipients. The Centrelink process pays in the morning, so they have all day to access their account.
- A direct debit may be processed but if, during the same day, other direct debits, withdrawals of Eftpos transactions and withdrawals from ATMs push the consumer's bank account into being overdrawn, the bank can simply reverse the direct debit processing.
- Banks can reverse a direct debit within 48 hours, on the basis of insufficient funds.
- If the consumer changes their bank account, there is no direct debit facility left to facilitate repayment.
- If a bank decides the direct debit is not right, a decision to change payment date or payment amount will be made unilaterally by the bank.
- Consumers are free to instruct their paying organisation to simply pay into another account, regardless of the existence of a direct debit on the current account.
- Banks offer the following to consumers - closing the account, stopping payment and refer to customer.

- The consumer can contact the lender or the bank to cancel.
- Once stopped a bank will not easily reinstate a direct debit.
- Consumers may have a daily maximum limit to their withdrawals that excludes the direct debit, because the funds withdrawn hit the maximum limit prior to the direct debit hitting the account.
- Bank fees are withdrawn by the banks first.
- Some banks may only process one direct debit per day.

Relevant inclusions in the Direct Debit Request and Direct Debit Agreements used by lenders generally include the following, which demonstrates the ease with which consumers can cancel their direct debit arrangements. Under the subheading "*Changes by you*":

1. "*...you may change the arrangements under a direct debit request by contacting* (the lender) *on the above phone, fax or email addresses.*
2. *If you wish to stop or defer a debit payment, you must notify* (the lender) *in writing at least three (3) days before the next debit day. This notice should be given to* (the lender) *in the first instance.*
3. *You may also cancel your authority for* (the lender) *to debit your account at any time, by giving* (the lender) *seven (7) days notice in writing, before the next debit day. This notice should be given to* (the lender) *before you contact your financial institution*".

Consumer's aware of cancellation opportunities

The Delegation is concerned that the Committee be alerted to the high proportion of consumers who already know their rights in this area. The April 2011 Lender Survey provides interesting statistics in regard to this issue:

- 69.2 of lenders revealed that they already had a clause in their contracts informing the consumer of their right to cancel a direct debit - a right consumers have always had.
- The need for this information may be relatively limited, given 83% of lenders indicated that 75%-100% of their consumers knew of their right to cancel their direct debit.
- The figures for current cancellations varied between lenders, with 66.6% reporting 0-5% of their consumers cancelling their direct debit and a further 10.2% reporting that 10-20% of their consumers cancelled their direct debit.

Inherent risks

A response supplied to the Delegation by a debt collector, concerning direct debits, points to the inherent risks in expecting direct debit payments to ensure repayment of loans:

"(Direct debit)*...is solely in the Customer's control, whereby they can cancel a Direct Debit at their whim, without costs to them and when it suits the Customer. This is the Law and the Finance Industry has no option in this regard. It is seldom that a Customer will contact the Finance Company and ask for the Direct Debit to be stopped, and the finance company then bears the cost of the failed debit.*

...Once the Direct Debit is cancelled by the Customer, it's certainly not an instant fix to try and have the payments back on track, as the customer then has to re attend the financial institution to have the Direct Debit reinstated, and with work commitments etc, it normally means that the debt then runs into a default situation with the customer finding it difficult to make up the payments, under the terms of the contract.

...The other thing that is not realised is that, whilst the customer had these funds outstanding,...the lender could be lending the monies to someone else who does pay, rather than having to chase this money at further costs...".

Given the above, it is inappropriate to assume direct debits guarantee loan repayment and significantly reduce the risk of non-payment for lenders.

The unreality of the myth that consumers are left without food

The Delegation asserts that the opportunity for consumers to be left without enough money for food, purely because of their contracted loan repayments, is highly unlikely.

Any such assessment must be considered in the light of the following:

1. Section 131(2)(a) provides that a contract must be considered "*unsuitable*" for the consumer if, following the rigorous assessment prescribed by Section 130, the lender comes to a reasonable conclusion that the applicant could not comply with the terms of a credit contract without suffering "*substantial hardship*".

   Obviously, leaving people without enough money for food would easily be regarded as an offence committed by the knowing lender. Such a mistake, or breach of the law under Section 131(2)(c) attracts a penalty of $220,000. Such behaviour, on the part of the lender, would also seriously threaten that lender's opportunity to retain, or renew, their Credit Licence under the licensing provisions included in the NCCP Regulations.

2. A comprehensive audit of the consumer's spending habits and preferences by the consumer advocates, would have been helpful. In other words, before the lender is accused, it is important to review what else the consumer is spending their money on.

3. The possibility that, in order to obtain the money, the borrower has lied about their financial circumstances, including falsifying supporting documentation, cannot be overlooked.

Security for Loans

The Delegation considers that the Committee should be aware of the procedure when a lender takes security to ensure repayment of a loan. Three types of security deserve consideration - security over houses, security over household goods and security over vehicles.

Security over houses

The Delegation is concerned that Ms Catherine Uhr from Legal Aid Queensland, representing National Legal Aid, presented evidence to the Joint Committee on Corporations and Financial Services, in October, which could have left an inaccurate picture in the minds of that Committee and anyone reading Hansard, concerning the taking of security over a payday loan.

The Delegation is of the view that a consequent problem had arisen in regard to the readers of two articles published since, in the Brisbane Courier Mail, based on the Ms Uhr's comments both before the Committee and thereafter.

Contrary to Ms Uhr's evidence, the Delegation has been unable to find <u>any</u> evidence that <u>any</u> borrower of a payday loan - the focus of the witness' comments - has signed over their house as security and/or lost their house, due to defaulting on their small amount, short term loan (under $2,000, under 2 years). In response to a question concerning taking security over a house for a loan of "$500 bucks", or "borrowing $1,000", Ms Uhr testified that "I have seen that done".

During 11 years of research and supply of services to the small amount, short term finance sector, Smiles Turner has <u>never</u> discovered an attempt to use a house or unit as security, to ensure payment of a small amount, short term payday loan.

To confirm this circumstance, a random sample of 25 Delegation supporter companies, with some 86 lending outlets and offices, responded to a question sent to them on Friday 28th October, 2011 -

"*How many times have you taken security on a house or unit owned by the borrower or their guarantor, for any loan, for any amount under $5,000*?"

All 25 respondents reported "never" or "zero". One respondent, with 3 retail outlets and a comparatively large lending business, responded, "*Maybe once or twice we have lodged a caveat or mortgage, the loans would have been closer to the $5,000 mark. These would be special scenarios*".

Any representation that might be interpreted as meaning numbers of consumers borrowing small amount, short term payday loans lose their houses when they default due to these loans, is completely untrue.

In the context of Ms Uhr's evidence and the two Courier Mail articles that have appeared to date, there appears to be an ongoing campaign to link security over houses with payday loans.

The Delegation is concerned to remind the Committee that the legitimacy of taking security is clearly prescribed in Part 3 of the National Credit Code, Sections 41 and following. It is important to note that the Legal Aid spokesperson does not allege any attempt by lenders to take prohibited securities (which are clearly prescribed in Section 50 of the Code and include superannuation, essential household property, tools of trade and cheques), but there appears to be an attempt to rewrite Section 49 of the Code.

Section 49(1) provides, "*A mortgage* (taking security) *is void to the extent that it secures an amount, in relation to any credit contract which it secures, that exceeds the sum of the amount of liabilities of the debtor of the credit contract and the reasonable enforcement expenses of enforcing the mortgage* (security)".

As the Committee would appreciate, that means it is illegal to take security over a person's property that is worth a lot more than the loan and then proceed to present that it guarantees repayment of an amount in excess of that borrowed plus reasonable enforcement expenses and the cost of the sale. This provision obviously does not stop the use of a borrower's property that is worth considerably more than the amount lent.

Because the section in the Code only allows the lender to secure the prescribed amount, if the loan fails, the lender has the right, as prescribed in the NCCP Act and regulations, to sell the secured item, generally at public auction. However, the lender must give back to the borrower any amount above the debtor's liability for the loan plus enforcement costs and sale costs.

Using only two examples to date, regarding taking houses as security - both from 2009 - in a Courier Mail article on November 14, Ms Uhr attempted to paint a greatly exaggerated negative picture of payday lending:

1. The Delegation is aware that one example was for a loan for $20,000. This could never be considered a payday loan, which is the focus of the Legal Aid campaign. In addition, security could have been "taken" for a very plausible reason. The house may have been the only security the borrowers had to offer.
2. The Delegation has been informed that the second case involved a loan of approximately $3,200 (also not a typical payday loan but, in fairness, a typical microloan), with security being "taken" over a house, there is no explanation that it was the only security of value the borrower had and the borrower wanted, and needed, the money.

In both cases, it must be remembered that taking the security was absolutely legal, is frequently used by 'mainstream' institutions and the arrangement was between consenting adults. Those adults have the legal right to marry, to vote and to sign binding legal contracts that are designed to indicate the terms and conditions by which the adults agree to abide. In addition, the Delegation would appreciate the Committee noting:

(a) To date, no further examples have been provided by Ms Uhr. Consequently, a reader of Hansard must be careful not to read any implication into Ms Uhr's response, "I have seen it done", that there have been any more than the above two occasions brought to Ms Uhr's attention.

(b) There has been no evidence presented that, in either of the two cases, the money was not legally borrowed.

(c) There has been no comment provided in association with the three public references to lenders taking security over a house, as to how their actions differ from the actions undertaken by mainstream bankers, literally thousands of times every business day.

Both examples occurred well before any consumer protection initiatives were introduced by the NCCP Act. It is only since 1 July 2010 that the circumstances involved in these 2009 cases could possibly have elicited critical review.

Under the responsible lending guidelines, you cannot lend if the terms of the contract would threaten the consumer maintaining their interest in their house.

For example, Section 131(2)(a) of the NCCP Act prescribes that a contract will be "*unsuitable for the consumer if… the consumer will be unable to comply with the consumer's financial obligations under the contract, or could only comply with substantial hardship…*". Subsection (3) prescribes that, for the purposes of subsection (2)(a), "*it is presumed that, if the consumer could only comply with the consumer's financial obligations under the contract by selling the consumer's principal place of residence, the consumer could only apply with those obligations with substantial hardship, unless the contrary is proved*".

This would provide an opportunity for a court to reopen the contract and mortgage, under section 76(2) of the National Credit Code, in regard to subsection (a) "*the consequences of compliance, or non-compliance, with all or any of the provisions of the contract, mortgage or guarantee;…*".

The Delegation notes that, even if the circumstances of the two cases were to have occurred post-1 July 2010, it is still possible that the lender may have proved that there was no hardship in the lender foreclosing on the security, in the consumer's circumstances.

It could be alleged that Ms Uhr is attempting a definition of the current legislative requirements, that implies retrospectivity. There is no retrospectivity in the NCCP or associated regulations.

Security over household goods

The Delegation is concerned to emphasise that no lender takes security over household goods. This has been <u>illegal</u> since 2010.

In 2010, the rules for both secured and unsecured loans established that:

1. You cannot attempt a security/mortgage over -
   (a) wages,
   (b) employment benefits,
   (c) superannuation,
   (d) a cheque,
   (e) bill of exchange, or
   (f) promissory note.
2. Under Section 50 of the National Credit Code, you cannot take security over "*essential household property*", as defined in Section 116(2)(b)(i) of the Bankruptcy Act, being -

   "Household property

   (1) For the purposes of subparagraph 116 (2) (b) (i) of the Act, household property of the bankrupt specified in this regulation is household property to which subsection 116 (1) of the Act (which deals with property divisible among the creditors) does not extend.

   (2) Subsection 116 (1) of the Act does not extend to household property (including recreational and sports equipment) that is reasonably necessary for the domestic use of the bankrupt's household, having regard to current social standards.

   (3) In particular (but without limiting by implication the generality of subregulation (2)), subsection 116 (1) of the Act does not extend to property of the following kinds:

   (a) in the case of kitchen equipment, cutlery, crockery, foodstuffs, heating equipment, cooling equipment, telephone equipment, fire detectors and extinguishers, anti-burglar devices, bedding, linen, towels and other household effects -- that property to the extent that it is reasonably appropriate for the household, having regard to the criteria mentioned in subregulation (4);

   (b) sufficient household furniture;

   (c) sufficient beds for the members of the household; and

   (d) educational, sporting or recreational items (including books) that are wholly or mainly for the use of children or students in the household;

   (e) 1 television set;

(f) 1 set of stereo equipment;

(g) 1 radio;

(h) either:

(i) 1 washing machine and 1 clothes drier; or

(ii) 1 combined washing machine and clothes drier;

(i) either:

(i) 1 refrigerator and 1 freezer; or

(ii) 1 combination refrigerator/freezer;

(j) 1 generator, if relied on to supply electrical power to the household;

(k) 1 telephone appliance;

(l) 1 video recorder.

(4) For the purposes of deciding whether property, other than property of a kind mentioned in paragraphs (3) (b) to (l) (both inclusive), is property to which subregulation (2) applies, regard must be had to the following criteria:

(a) the number and ages of members of the bankrupt's household;

(b) any special health or medical needs of any of those members;

(c) any special climatic or other factors (including geographical isolation) of the place where the household residence is located;

(d) whether the property is reasonably necessary for the functioning or servicing of the household as a viable and properly run household;

(e) whether the costs of seizure, storage and sale of the property would be likely to exceed the sale price of the property;

(f) if paragraph (e) does not apply -- whether for any other reason (for example, costs of transport) the sale of the property would be likely to be uneconomical.

(5) The preceding provisions of this regulation do not prevent subsection 116 (1) of the Act from extending to antique items.

(6) For the purposes of subregulation (5), an item is taken to be antique if, and only if, a substantial part of its market value is attributable to its age or historical significance."

3. You cannot attempt a mortgage over tools of trade that the borrower personally uses to earn a living. That is unless they have a total value in excess of that prescribed in Bankruptcy Regulation 6.03B,

"*6.03B Property divisible among creditors - prescribed amounts*

(1) For the purposes of subparagraph 116 (2) (c) (i) of the Act, the maximum total value of a bankrupt's property that is for use by the bankrupt in earning income by personal exertion is:

(a) in the case of a bankruptcy occurring or continuing in the period commencing on the commencement date and ending at the end of 30 June 1997 - $2,600; or

(b) in the case of a bankruptcy occurring in a financial year commencing on 1 July 1997 or on 1 July of a subsequent year - the amount worked out in accordance with subregulation (2).

(2) For the purposes of subparagraph (1) (b), the applicable amount is:

(a) in the case of the financial year commencing on 1 July 1997 - $2,600 increased in accordance with the CPI rate for the financial year that commenced on 1 July 1996 and rounded down to the nearest multiple of $50; and

(b) in the case of a subsequent financial year - the amount worked out in accordance with this subregulation for the immediately preceding financial year, increased in accordance with the CPI rate for that financial year and rounded down to the nearest multiple of $50".

Security over motor vehicles

Given the above, apart from antiques, the only other viable property to use for security is a motor vehicle. This is an issue that is occasionally commented on by consumer advocates, but the Delegation includes the following contents for the Committee's information. It should be noted that the provision of a motor vehicle as security is quite common both in small amount, short term lending and in the mainstream finance sector.

As discussed later in this section, the value of many second hand cars is not high and frequently loans of under $1,000 involving motor vehicle security are associated with a vehicle that will not achieve any more than the loan principal, if sold at auction. That is why the celebrated case of a Queensland loan, involving security over two motor vehicles, was a sound business decision on the part of the lender.

Lenders and their agents cannot enter a property to repossess the vehicle unless the owner of the property has signed a Form 13, as prescribed by Subsection 99(2) of the National Consumer Credit Protection Act 2009 and Regulation 87 of the Regulations 2010. This Form gives permission for the lender, or their agent, to enter the property.

However it is important to note that, when faced with a failed loan, many lenders simply do not bother attempting to actually repossess the vehicle. There are great practical, often personal (as well as legal) difficulties involving access to private property in order to recover a vehicle parked inside a garage or inside a yard. Further, vehicles are, of their nature, mobile and easy to hide in friends' garages, or distant suburban streets and the like.

Smiles Turner research in 2006, 2007 and 2010 indicated virtually none of the payday lenders seek security and the percentage of total small amount, short term lenders who attempt security over a motor vehicle is consistently less than 34%.

There are a number of factors that encourage a lender to use the taking of security over a motor vehicle merely as a symbolic gesture. These include:

1. the cost of repossession being between $500 and $800 for the repossession and tow;
2. a small debts court application costing between $800 to $1,200;
3. the borrower deliberately hiding the vehicle;
4. in most states, such as NSW, it is difficult to attempt a repossession if the vehicle has been on-sold to another person, as the lender and their agent are not permitted to check ownership as against state Road Traffic Authority records; and
5. while the Red Book (the motor vehicle dealers' guide to vehicle value) might indicate that a vehicle is worth $4,000, at auction the successful bid tends to be $1,200 to $1,500. Smiles Turner industry analysis reveals that most secured vehicles presented at auction achieved successful bids of between $500 and $800.

Serious long term debt trap

Consumer advocates repeatedly allege that numerous, if not most, consumers end up being caught in a debt trap, e.g. Ms Catriona Lowe, CALC, was quoted in The Age on 30th October 2011, as follows, "*The problem, she says, is that most people using this type of lending facility are repeat borrowers who need money for every day living expenses and who quickly spiral into debt. "These type of loans do not help a person who can't meet the day-to-day costs of living" Lowe says*".

The Delegation is concerned to draw to the Committee's attention the information from the diverse group of lenders who participated in the 2011 research in regard to controlling the level of delinquent borrowers.

The sample averaged:

- 6.54% bad debt (including people who missed one or more payments, but still paid off the loan). That means 93.46% of loans went full term, without a hitch.
- 1.52% of borrowers applying for hardship recognition, because of an adverse event occurring after they had entered into the loan; and
- 4.3% of loans which were never fully repaid. That means 95.7% of microloans taken out, even with defaults or hardship applications included, were fully paid off by the consumer.

However, all these figures represent a cost to the lender that has got to be met out of permitted gross interest, fees and charges.

It is therefore not in the lender's interest to facilitate the downward slide of a consumer into some form of debt trap, where the possibility of being unable to recover their funds is prevalent.

The Delegation does not deny that a small proportion of borrowers do end up in a debt trap. When frequently refusing loans applications, lenders supporting the Delegation observe many causes of consumer indebtedness leading to the overall conclusion that advancing a loan to the particular consumer would be "*unsuitable*". There would be more validity to the consumer advocates' claims if they could attempt the same analysis of the consumers' financial and lifestyle circumstances and provide such analyses for public consideration.

It would extremely useful if the consumer advocates were to adopt an assessment form similar to that used by lenders, under the NCCP Act responsible lending requirements, in regard to 90 Day assessments, before any conclusion or implication is made that the financial problems were 100% the result of payday loans.

Bankruptcy

On occasions, in recent years, consumer advocates have raised the issue of bankruptcy in relation to payday loans.

In regard to bankruptcy, the Delegation believes it is significant to note:

1. Small amount, short term ending never appears in IPSA statistics as causing bankruptcy.
2. Smiles Turner research reveals there has not been any court action by lenders, to recover debts, in the last 2 years.
3. No lender surveyed has ever initiated a bankruptcy proceeding.
4. In regard to participation as one of the creditors in such proceedings, the Smiles Turner industry surveys have not revealed a rate higher than 0.66 per outlet (2010 survey), for the whole time since the commencement of the lending businesses, regardless of the years involved.

Part IXs and Part Xs

The Delegation is aware that consumers have occasionally been encouraged to enter a Part IX or Part X, by financial counsellors and consumer advocates.

This is an unpleasant issue which generates high cost for lenders. That is the opportunity for borrowers in difficulty to engage an organisation to arrange a Part IX or Part X under the Bankruptcy Act.

The Delegation believes that this constitutes a redesignation of fees paid by the customer which means that, instead of money going to the lender creditor, this money goes to an Administrator. In the majority, these Administrators collect their fees first.

If the Administrator does not successfully collect their fees from the consumer, they rarely chase any debtors. The end result is the debt is simply given back to the creditors 12-24 months later, with little chance of collection due to the age of the debt. In this context, it must be remembered that the consumer has signed a legally enforceable agreement with the original lender, who is left even worse off financially because of the process.

Credit rating "repairers" (debt consolidation)

There is a second unpleasant issue which generates costs for lenders. That is the opportunity for borrowers to allow so called "credit repairers" to represent them in a specious attempt to avoid their contractual obligations. In fairness to the consumer advocates, these services could be viewed as their competitors and the Delegation includes mention of them to complete the picture.

The Delegation is aware of a number of these services that charge a fee from a few hundred dollars up to $3,000. The services' central weapon in their sales pitch to consumers in trouble is that they can get a negative listing on the consumer's credit file removed. The manner in which this is undertaken rarely reflects a legitimate mistake or issue of disagreement and, overwhelmingly, involves tactics that are nothing short of blackmail. Unfortunately, there are instances of consumer legal services adopting similar tactics.

The service threatens the lender with a complaint to their EDR service, that will generate a minimum of $145 (Financial Ombudsman Service) and $165 (Consumer Ombudsman's Services Limited) just for the complaint lodgement, lots of inconvenience responding to both the credit repair service and the EDR and possible costs, up to $4,000, if the matter proceeds to full consideration by the EDR service. Even if the lender wins, the complainant borrower does not pay anything. In most circumstances the potential financial and inconvenience downside far outweighs the hundreds of dollars owing - and the lender acquiesces.

The result is the lender loses the opportunity for complete repayment of the perfectly legitimate loan. Further, the credit reporting system develops a major flaw, where defaulting consumers are removed from the list, so a subsequent lender is not alerted to a potential problem when seeking a credit reference regarding an application by the previously defaulting borrower.

Average number of loans

One area of misinformation presented by consumer advocates, has been that which concerns the number of small amount, short term loans entered into by consumers. The phrase most commonly used is that "*most people*" using this type of facility are repeat borrowers. While the Delegation recognises that there are borrowers who make repeated attempts, over a period, to acquire numerous loans, the information from the databases of the participant companies in the 2011 Industry Analysis Survey indicates relative restraint.

The Smiles Turner May 2011 Supplementary industry study indicated the average number of loans taken out per customer, over the last 12 months, from companies with a total of 73 lending outlets or offices, were as follows:

Number of companies	Av. number of loans per customer
2	1
2	1.3
4	1.5
1	1.6
1	1.7
5	1.8
6	2
1	2.2
4	3
3	4
28 companies	Av. loans per customer - 2.18

Repeat Loans (Rollovers) - the Reality

The consumer advocates are particular concerned about repeat loans, or rollovers. However, the Delegation claims that this issue is exaggerated by the consumer advocates when considered in context. Further, the opportunities for introducing restrictions on rollovers attract a number of difficulties that belie the apparent simplicity of the option.

Rollovers in context

For the different lenders, the employment and popularity of rollovers varies dramatically. In April-May 2011, 39 companies responded to a Smiles Turner industry research program that involved questions concerning rollovers. The results are summarised in the following table, which shows the proportion of consumers that seek one or more rollovers, expressed as a percentage.

No. per loan	No. of Lenders who permit rollovers	Range	Average Total Sample	Average Permit *
1	27 out of 39	0-95%	18.18%	27.6%
2	27	1-85%	14.9%	21.4%
3	24	3-30%	9.36%	15%
4 or more	15	5-85%	5.72%	14.87%

***** Please note, the last column is the average for lenders who permit rollovers.

Current industry practices

The Delegation has reviewed the results of the 2011 research and the practices of the leading responsible lenders in the microlending sector. These companies have rollover policies that range from not allowing any, to allowing 3 rollovers. Any further application is refused, with a demand that the existing loan be fully repaid before any further credit is contemplated. The figure of 3 was adopted for the option presented in the analysis of the current Bill earlier in this Submission.

The rationale for prohibiting rollovers

The rationale for adopting a prohibition on rollovers cannot include a claim that a rollover is evidence a consumer can't afford their existing loan. Rollovers frequently emerge because, having already repaid most of the original principal, the consumer is faced with a spending opportunity that requires money now, not borrowing sometime later after an existing loan has been completely repaid. There is also the issue of debt consolidation, where it makes economic sense for a series of debts to be amalgamated.

The number of consumers involved in rollovers is not substantial

The Smiles Turner industry research in April 2011 found that, for all 39 companies with their 84 lending outlets, the average was 2.4% of total customers who were provided with rollover opportunities. For those companies that allowed rollovers, the average number of consumers was 4.94%, with 13 of those companies reporting 5% or fewer of their customers borrowing in such a manner, in whole or part.

In the 2011 Lender/Broker Survey, 28 of the 39 lenders (72%) answered yes to the following question, "*Would the best solution (for rollovers) be to allow 3 rollovers and then stipulate that the third must be fully paid out before further credit can be offered?"*

The CALC 2010 report included data indicating that 73.9% of respondents had taken out no more than 2 loans in the last 18 months (page 2). The RMIT report included mention that 77% of respondents had not rolled over a single loan (page 17).

Rollover Statistics

In 2011, 69% of the companies polled offered rollovers. In a national survey undertaken by Smiles Turner in 2006, involving 73 retail outlets, the number was 47.7%. The 2010 and 2011 research also indicated that, after a third rollover associated with an individual loan, further rollovers became relatively uncommon.

Consumers like rollovers

To that end, it may be useful to note that 30.7% of the consumers participating in the Consumer Snapshot 2010 study, had <u>sought</u> a rollover that year. The much lower provision of rollovers, by their lenders, in part reflects the impact of assessment associated with responsible lending.

Rollovers and staying in business

One of the May 2011 survey questions was, "*If rollovers were prohibited, could the company stay in business?*". The responses were:

- Prohibiting all (1 or more) rollovers - 19 of the 39 companies (49%) could not stay in business.
- Prohibiting 2 or more - 16 companies (41%) could not stay in business.
- Prohibiting 3 or more - 14 companies 36%) could not stay in business.
- Prohibiting 4 or more - 6 companies (15%) could not stay in business.

These statistics indicate one of the reasons why the exit of lenders from the sector will commence on or before the 1st July 2012, rather than all leaving on or about 1 January 2013.

Multiple rollovers

The Delegation is of the view that, where more than 3 multiple rollovers occur, there may be a serious issue in regard to repayment of the loan. This could reflect less than diligent assessment and verification duties by the lender.

A possible reason may be that, although the lender may have been very diligent in applying the responsible lending criteria during the application period, the consequent request for rollovers may not have emerged until some time during the term.

Further, to assume that a rollover is only requested because the consumer is in financial difficulty may be erroneous. It may simply reflect the fact that the consumer has an opportunity of benefit, of which the consumer would like to take advantage. Further, it is often overlooked that the request for a rollover generally does not involve the consumer seeking, in total, more funds than that for which the consumer was originally approved. If the consumer's fundamental financial circumstances have not changed, then the original 90 Day Assessment remains valid and on foot.

The suggested prohibition beyond 3 rollovers also recognises that, as debt increases, lenders face exponential growth in non-recovery charges.

The Delegation recognises that concern for the "*debt spiral*" has validity for a <u>small</u> minority of consumers and offers support, in principle, for practicable prohibitions. However, in the context of responsible lending provisions now in force, the Delegation does not consider that 1-3 rollovers, during the term of the loan, constitutes a debt spiral.

The Smiles Turner 2010 research indicates that approximately 80% of consumers do not apply for a rollover. In addition, Smiles Turner industry research, in November 2010 and April-May 2011, revealed in excess of 90% of the consumers who were offered rollovers successfully repaid their loans.

Challenges associated with prohibition

While the Delegation supports some restriction on rollovers as a compromise and accepts that rollovers can be an indication of inability to repay within the original contract term, the following should not be overlooked when assessing the value of any prohibition:

1. Sometimes rollovers represent a legitimate extension of credit, recognising a genuine new and positive need for that credit.
2. Sometimes it may be little different than borrowing from a friend or family member to repay the outstanding balance of the first loan, and then borrowing again, with some of the new loan funds going towards repaying the friend or family member.
3. As the Discussion Paper, "*Payday lending in South Australia - options to increase consumer protection*", Government of South Australia, Office of Consumer and Business Affairs (2006) noted, at page 19:

   "*In practice it may be very difficult to enforce a prohibition on roll-overs. A prohibition on roll-overs could not easily prevent a borrower from obtaining a loan from another payday lender to repay an outstanding loan from the first payday lender. Indeed this might be* *circumvented by splitting into separate entities and referring borrowers between entities for further loans*".

4. It may be too hard to determine a 'one size fits all' policy. Establishing the criteria that distinguishes between lenders and between numbers of occasions when the consumer can take out a new loan, is far too complex and uncertain.
5. The concept conflicts with the mandatory responsible lending now required. There would be situations where the consumer satisfies every element of the comprehensive assessment and the loan is capable of being deemed "suitable", but the prohibition on repeat borrowing interferes with this fundamental concept.
6. While rollovers may attract criticism that they indicate poor financial self-management on the part of a micro-borrower. However, refinancing - as private sector business understands it - is a very legitimate liquidity and investment or business development funding strategy. There are legitimate parallels in personal borrowing.

Rollovers and the 90 day assessment

It must be accepted that the current 90 day assessment is undertaken to test whether or not a level of indebtedness associated with the loan required by the consumer, is tolerable throughout the succeeding 90 days. If the rollover loan amount is comparable to that originally borrowed, as previously mentioned, introducing a prohibition or limitation on rollovers demonstrates a belief that the assessment/responsible lending regime, introduced on July 1, 2010, has been a failure.

Arguments against prohibiting rollovers

There are at least 3 significant arguments against the prohibition of rollovers. They are:

1. Prohibiting rollovers overrides responsible lending and fails to recognise changes in circumstances. It also fails to recognise that every consumer's circumstances are different and that a number of consumers will simply use multiple lenders.
2. Prohibition of rollovers also introduces the possibility of encouraging consumers to borrow more than they actually need, at a particular time, in case a later circumstance occurs. This would encourage irresponsible borrowing behaviour. In addition, a refusal to accept a rollover application may simply encourage that consumer to go to a competitor. In these circumstances, there is an enhanced chance that the consumer will default on the first loan.
3. The introduction of rollover regulation of any kind implies that the Government's responsible lending and assessment policies have already proven inadequate. It is far too early to imply such.

It is to be hoped that there will be the opportunity to explore with consumers the impact of any plans to prohibit rollovers. Regardless of one's assessment of the concept, there are a considerable number of consumers in the marketplace who accept and rely on the concept of a rollover as part of their financial management strategy.

The merits of introducing a prohibition on rollovers must be weighed against consumer requirements due to changing circumstances, as well as the new assessment regime, which demands recognition of "suitability" before any rollover is approved.

Monitoring and compliance, with rollovers prohibited

With rollovers being prohibited, a monitoring and compliance regime faces the following questions:

1. There is the issue of avoiding the consumer simply going off to another lender and getting a second loan, and then returning to the first lender and paying off the first loan. In the absence of promised comprehensive credit reporting or a small loans register, there is the possibility that the second lender may never learn of the first loan.
2. There is the problem as to what happens when a consumer provides information to a new lender, that the previous lender will not confirm?
3. As indicated elsewhere, the Delegation is concerned that it will be hard to avoid the consumer taking out a larger loan than they need, on a "just in case" basis? Such

providing an excess of funds above their original objective and a period of greater indebtedness that could have been avoided with a more modest rollover.

4. Equally, particularly under the conditions the current Bill will create, it will be difficult to avoid consumers doing business with illegal lenders.

It should be noted that legal avoidance can be achieved, under the current Bill, by the customer simply taking out a loan over $2,000, for over 2 years.

The Delegation assesses that monitoring any prohibition of rollovers will be a nightmare.

Prohibiting more than one loan

The consumer advocates maintain that prohibition would assist in cutting out debt spirals. The Delegation considers that the issue of debt spirals is one for responsible lending and the employment of the mandated assessment protocols. As a matter of choice and financial management, many people have more than one loan and still adequately manage their finances.

The Smiles Turner consumer profile research, in April 2011, indicated that in excess of 20% of the 1,305 borrowers responding had more than one loan at the time they took out the loan on the day of the research. This situation is not dissimilar to the vast number of Australians who have both a car loan and a house loan. However, these people generally have three sources of debt - car, house and the credit card.

Simultaneous (2+) loans

In 2011, lenders were also asked the percentage of customers who had more than one loan, simultaneously, from that company, over the previous 12 months.

The range of customers with more than one loan, simultaneously, was 0 to 8%.

Each of four companies reported 0%, 1%, 2% and 3% and two companies reported 8%. The other 23 companies (74% of respondents) reported that none of their customers were granted more than one loan at any one time.

The above findings are not dissimilar to the CALC 2008 research. 7.4% of the CALC respondents replied “Yes” to the question - “*Have you ever had more than one payday loan at the same time?*”.

It is interesting to note that in Florida, USA, the statistic is 8.4% and, in Oklahoma, 9.3%.

Number of loans taken out

While there are cases of consumers taking out numerous loans in a period, such cases must be viewed in the context of the whole borrowing population.

The 2011 Consumer survey revealed the average number of loans taken out by borrowers in 2010 was 1.78, with 51.8% having taken out one loan, 22.8% two loans and 25.4% taking out three or more loans.

The Committee is cautioned not to compare these numbers with the results in this category included in the RMIT study. As indicated elsewhere in this Submission, the RMIT question had not limitation on the amount of time involved, so respondents replied with the number of loans they had ever taken out, not just in the previous 12 months.

Ability to repay ignored

Prohibiting the lender to lend when a consumer already has another loan, overlooks the fact that the consumer may not have any different ability to repay the two loans, while adopting a modest lifestyle, than the consumer who has only one loan but enjoys an “extravagant lifestyle”.

Such a prohibition also implies that the lender will be able to easily access information as to whether or not the consumer has one or more other loans. Until comprehensive credit reporting is introduced, this level of access is not available.

One challenge for the lender is that, apart from commercial loans, there are other lending or credit arrangements that do not necessarily reveal themselves on the credit applicant's bank statements. Arrangements concerning payment with utilities, repayments for Centrelink advances, and loans from friends and family are in this category.

In circumstances where an earlier loan is with another lender, that lender should be required to provide a copy of the loan to the second potential lender, without which the second lender should not be held accountable. Unfortunately, issues under the Privacy Act restrict this opportunity.

The challenge for any sanctioned regime concerning lending where the consumer already has a loan, will be to recognise that the lender may have been lied to by the consumer in regard to the claimed non-existence of an earlier loan. The lender should not be penalised in circumstances where there is no comprehensive credit reporting facility to assist in checking the consumer's honesty. In these circumstances, the consumer should be prosecuted for fraud.

The lender should be free to exercise their own judgement and apply their own risk assessment, in regard to the provision of a second loan.

Consumers unaware of cost

The Delegation is concerned that some consumer advocates claim borrowers are unaware of the cost of their loans, e.g. CALC 2010 Report - page 6 - "*High cost short term loan borrowers exhibit an astonishing lack of knowledge concerning the cost of lending, both in interest rate and dollar amount terms*".

All the Smiles Turner consumer research surveys dispute this statement. At least 71% of respondents in all surveys indicated that they were aware of the cost of their loans.

In two Smiles Turner consumer surveys in 2010 and 2011, consumers were asked to evaluate the cost of the loan and default fees, under the headings "very expensive", "expensive", "fair" and "cheap". The highest number of respondents who could not answer the questions was 1.6%. Obviously, in order to answer the question, you had to know the prices being charged by the lender.

If the borrower does not ask, or the lender does not verbally or by signage tell the consumer the price of credit offered, the mandatory Financial Table included in the pre-contractual statement and the inclusion of the costs on the front page of the contracts, both mandatory under the National Consumer Credit Code, clearly informs them - before they sign.

The awareness of interest rates, as opposed to other issues, was explored by Smiles Turner in a 2006 survey investigating lenders' knowledge of customers' motives. 35 business owners, with 1 to 105 outlets (total 276 outlets) were asked, "*In YOUR experience with borrowers, how would you rate the following - from 1 - very important; to 5 - least important for your "average" customer*".

Question	Average rating
Total cost of loan	1.6
Amount of each repayment	1.8
Length of repayment period	2.7
Repayment intervals	3.1
Interest rate	3.5

Given the current Bill's focus on interest rates, it is interesting to note that, according to the lenders surveyed, this figure is the least important to borrowers.

In 2010, the managers or owners of 206 lending outlets, nationally, were asked, in their opinion, what percentage of their outlet's customers were aware of at least one competitor offering similar loans. The answers were:

- 71.7% said 95% or more of their customers were aware of at least one competitor;
- 8.3% said 90%; and

- 10% said 70%.

In November 2010, the owners and managers of 205 lending outlets nationally were asked a question, posed in the negative, to explore their assessment of customer price awareness. Their estimates were:

41.5% of the owners or mangers responsible for the 205 outlets, estimated 90% of their customers were influenced by cost;

62% considered 50-65% of their customers were influenced by cost;

99% believed that all customers were aware of the cost.

12.4% of outlets indicated that they had lost customers on the basis of price and this was the third most prevalent reason for losing a customer.

69% of outlets reported that 40% or less of their customers appeared to care about the cost of credit.

SECTION 8

Consumer Protection Continues

This Section considers the context in which the recommended alternative model will be operating, if adopted.

A Consumer Profile

There has been much debate concerning consumers' awareness of and sensitivity to cost, when choosing their credit provider. The research results included in this Section reveal the dynamics that must be recognised by the Committee, when assessing consumers and the costs of their small amount, short term loans. To date, such an assessment has not been undertaken. This Chapter considers the reasons for borrowing, consumer awareness of competition and price, non-cost issues, consumer complaints, consumer fraud and where consumers will attempt to go post-1 January 2013. A concise summary of relevant Smiles Turner survey statistics concerning consumers is included in Appendix 6.

Reasons for borrowing

High profile consumer advocates have expressed considerable concern in regard to the reasons consumers borrow. Their argument is that much of the borrowing is for weekly "*living expenses*". Their associated argument appears to imply that borrowing for such purposes is unacceptable and should be curtailed.

Given the lack of adequate non-commercial sources of funds, the Delegation cannot accept this argument and submits that the high level of borrowing for "*living expenses*" emphasises the great importance of having a loan source available to the consumers involved. In accordance with our society's standards, deprivation of funding for "*living expenses*" must be considered a very serious issue.

From a financially comfortable middle-class perspective, it may be that borrowing for purposes that could be classified as "*weekly expenses*", or "*normal living expenses*", or "*everyday living expenses*" is of concern. The Delegation submits that the Centrelink benefits system; the availability of only casual, part-time or low paid work for many who are in less fortunate socio-economic circumstances; the education system; how we select our immigrants; or whatever else contributes to our three level economy, is to blame for creating the demand.

We do not disagree with the research results achieved by RMIT University where, in their Executive Summary, they noted the purposes for a lot of the demand for loans - "*When asked why they first took out a loan, the most commonly cited* (not the majority) *reasons... were to meet regular, weekly-type needs and expenses*". The reasons for taking out all prior loans were almost equally "*irregular needs and expenses*" and "*regular weekly-type needs and expenses*".

Relevant Smiles Turner research results support this generality (2006, 2007, 2010).

As revealed in the evidence given before the Joint Committee on Corporations and Financial Services on 23rd October 2011, CALC attempted to blame the lenders for society's circumstances and the choices made by adult borrowers.

This implies that the right to make choices should be denied to the payday/micro-loan borrower, simply because CALC believes it knows what's better for them. There is an argument that this unfortunate approach ignores the borrower's basic rights and sense of self worth, independence and dignity, which has been identified as important in a number of studies including the following:

1. "*Access to some form of credit is a prerequisite in enabling many individuals to exercise their right to basic household goods and other necessities. The use of credit for the low income earner is governed by need rather than choice*".

   ...Dr B. Hahn, "*Just Credit - Should Access to Credit be a Citizenship Right?*", published in March 1997, under the auspices of Good Shepherd Youth and Family Service, page 15.

2. "*Interestingly, customers reported that they liked the sense of independence, privacy and self esteem that comes with having access to credit otherwise denied to them by mainstream financial service providers. This is consistent with the findings of American research on the use of high cost credit by consumers*"

   …Dean Wilson, *"Payday Lending in Victoria - A Research Report"*, Consumer Law Centre Victoria Ltd, July 2002, p. 10.

3. In the Ministerial Council on Consumer Affairs discussion paper, "*Fringe Credit Providers*", August 2003, the paper quoted the Consumer Law Centre Victoria's study. This study reported that customers liked the sense of independence, privacy and self esteem that comes with having access to credit, which was otherwise denied them by mainstream financial service providers.

4. In the paper, "*To their credit - evaluating an experiment with personal loans for people on low incomes*", Scutella and Sheehan, Brotherhood of St Laurence, May 2006, at page (ii), "*Many participants had mistrusted banks and not applied for credit at a mainstream institution for fear of being rejected. …For many participants, obtaining a loan was about more than just money, but also dignity, inclusion, trust and respect. It was an opportunity to not be just a passive recipient of welfare, but to gain some self-esteem by taking a positive active role in the process. Participants felt a sense of pride in dealing with a bank*".

Reducing the number of loans

The consumer advocates' attention appears to be focused on "*a lot less loans*", not what that will mean to the consumers unable to borrow elsewhere.

The consumers responding to the 2010 Smiles Turner Consumer Snapshot study were asked "*If you can't get the loan you want today, will that cause you hardship?*". 66.3% responded "YES".

The Policis research report "*The Effect of Interest Rate Controls in Other Countries*" (July 2004, research conducted in France, Germany and the UK, for the UK Department of Trade and Industry) also indicated that an exit from the market, by lenders, led to the creation of financial exclusion and personal distress for consumers.

The Delegation has repeatedly argued that the effective abolition of payday and microlending, under the current Bill, will create a socio-economic disaster.

What the consumer advocates fail to address is the significance of how relatively few of the reasons can be described as "*discretionary*", or easy to go without. Implying that loans should not be offered for such purposes, without any attempt at providing a solution, is not assisting the consumers.

In addition, the Delegation remains concerned as to whether or not it is appropriate, in our democratic Australian society, for one relatively privileged small group to impose their values on another group who have shown no indication that they want their freedom of choice curtailed, or their self-esteem inhibited.

In our society car registration is essential. In our major cities, ownership of a repaired and roadworthy car, to get to work, is often essential. Our lifestyle demands electricity, telephones, insurance and school uniforms as essentials.

In addition, what the consumer advocates have failed to address is how much of this possibly discretionary borrowing has major psychological necessity attached to it, making the relatively high cost of the loan acceptable. For example, whether or not you can give your child the birthday present they really want, or whether or not you can give your child a simple birthday party, just like all their friends have, or whether or not you can travel to your parent's funeral. The 2010 research provided a range of these emotion linked reasons, indicating considerably greater non-financial disadvantages if the loans had not been taken out.

In these circumstances, being critical of the reasons why others - generally financially less fortunate than yourself - actually borrow, is no justification for supporting the current Bill, which effectively abolishes most legal lending for those purposes.

The Delegation has considered the following research results, which are largely compatible with the results from the 2006-2007 National research revealed below and that which was included in the 2010 CALC report.

In the 2006 research program, the following purposes for applying for the loan were given:

%	Purpose given
4.1%	Special occasion
29.8%	Bills
8.1%	Car expenses
32.9%	Personal (no details)
5.6%	Groceries
3.9%	Holiday
3.6%	White goods/electrical goods/furniture
2.4%	Medical
2.1%	Education
3.7%	Family
1.3%	Home maintenance
1.1%	Tools
1.4%	Moving home

The 2007 South Australian Customer Survey results were as follows:

What will you spend today's loan on? *(Subject: number of respondents)*					
Bills	**135**	Clothes	**5**	Optometrist	**2**
Food/groceries	**117**	Bridging finance	**5**	Birth Certificate	**1**
Shopping	**86**	Pets	**5**	Available goods	**1**
Living costs	**60**	Car registration	**4**	Repaying other debts	**1**
Car repairs/ maintenance	**53**	Medical expenses	**4**	Family	**1**
Petrol	**30**	Utilities	**4**	Family emergency	**1**
Christmas gifts	**25**	School fees	**4**	Gifts	**1**
Children	**24**	School uniforms	**4**	Good drugs	**1**
Birthdays	**18**	Don't know	**3**	Car tyres	**1**
Personal	**13**	Telephone	**3**	House maintenance	**1**
Rent	**12**	Valentine's Day	**2**	Wedding	**1**
Entertainment	**10**	Cigarettes	**2**	Fares	**1**
White/electrical goods	**9**	Education	**2**	Removalists	**1**
Holidays	**6**	Boat expenses	**2**	Dentist	**1**

In 2010, the NAB Fast Money quarterly report provided the following breakdown regarding the loan purpose:

Purpose	**% of applicants**		**% of successful applicants**	
	Jan-Feb	**March**	**Jan-Feb**	**March**
Pay Bills	31	29	21	10
Purchase Item/s	11	11	15	0
Holiday/Spending Money	11	15	17	40
Car Rego or Repairs	12	16	6	20
Pay off other debt	5	7	12	10
Dental Expenses	4	3	4	10
Purchase Food/Groceries	1	2	0	0
Veterinary Expenses	0	0	4	0
Other	24	17	21	10

In 2011, consumers provided the following reasons for their loans:

What is the main reason you are borrowing today? *(Subject: % of respondents)*					
Bills	20.6%	Shopping	2.2%	School uniforms	0.7%
Car repairs/ maintenance	9.6%	Family emergency	2.0%	Funerals	0.7%
Living costs	8.4%	Food/groceries	1.8%	Computers	0.6%
Holidays	6.6%	Children	1.6%	Other	0.6%
Personal	6.0%	Birthdays	1.5%	Petrol	0.4%
Vehicle purchase	4.4%	Education	1.5%	Pets	0.3%
White/electrical goods	4.0%	Entertainment	1.0%	Clothes	0.3%
Bridging finance/ finance	3.8%	Business	1.0%	Furniture	0.3%
Rent	3.7%	Wedding	1.0%	Boat expenses	0.3%
Car registration/ insurance	3.1%	Travel	0.9%	Removalists	0.3%
House maintenance	3.1%	Gifts	0.9%	Gambling	0.2%
Medical expenses	3.0%	School fees	0.7%		
Utilities/rates	2.7%	Legal	0.7%		

Non-cost issues

There may be an issue of people being aware of other credit source options, but employing criteria other than cost in their decision to stay with a particular microlender, e.g. Smiles Turner’s 2001 survey in metropolitan Sydney, which asked the question, “*Why borrow from a payday lending outlet?*” -

- 64.6% said - better than a pawn broker.
- 63% - good service.
- 41.9% - too small an amount for a bank to be interested.
- 28% - unable to use a bank.
- 22% - bad credit rating elsewhere.
- 17% - no security available.

The Smiles Turner 2006 Customer Survey had 465 respondents. The percentage of respondents who indicated the following reasons for borrowing from their particular lender were:

- 36.4% - service related;
- 22.8% - convenience;
- 12.1% - customer loyalty;
- 9.9% - able to borrow small amount and short length required.

In regard to criteria other than cost, the 2006 Customer Survey indicated the percentage of respondents who borrowed for the following reasons were:

- 36.4% - service related;
- 22.8% - convenience;
- 12.1% - customer loyalty;
- 9.9% - able to borrow small amount and short length required.

The Smiles Turner 2007 Customer Survey provided the following responses to two questions:

At present, do you have access to other forms of credit?				**Yes: 27.9%**	**No: 72.1%**
If yes, why didn't you take out today's loan with them? *(Reason - % of 112 respondents)*					
Convenience	23.3%	Services not offered	1.8%	Avoiding pawn brokers	0.9%
Better loan service	15.2%	Close to where I live	1.8%	Bank loans not easy to manage	0.9%
Credit card maxed	14.3%	Banks too complacent	1.8%	Husband will kill me	0.9%
Personal preference	12.5%	Already have a loan	0.9%	Personnel here understand me	0.9%
Quick service	10.7%	Bank closures	0.9%	Banks no personal loans	0.9%
Banks too difficult to deal with	5.4%	Facility card	0.9%	Small loans not provided	0.9%
Comparative high interest rates	4.5%	Accommodating	0.9%	Too far to go to avoid a fine	0.9%

Smiles Turner, November 2010 consumers survey revealed that 19.24% of respondents gave convenience (of location) as the reason for choosing the particular lending company. This was closely followed by good service - 18.53%, friendly staff - 10.45%, and indications of long term customer loyalty - 13.54%.

Why Borrowers, with access to other credit, use microlenders

The issue as to why borrowers with other sources of credit continue to use payday and microlenders is significant. This because it looks at the attitudes of borrowers who are not *"desperate and vulnerable"* but, if the current Bill goes ahead, will have their right of choice severely curtailed when it comes to legal sources of borrowing.

The 2010 Consumer research discovered that a wide variety of alternate forms of credit had been used by respondents during the 2010 year. This variety indicates the substantial number of respondents that, at this time, could not be considered "*desperate or vulnerable*". However, if the current Bill was to be enacted without change, many of these borrowers could well end up *"desperate and vulnerable"* because their alternate sources of finance would not be able to cope with the massive increase in demand following the lenders' exit from the industry.

Use of alternatives

Credit type	% of respondents
Credit cards	25.44%
Store cards	6.36%
Hire purchase or lease	6.05%
Furniture/appliance rental	10.88%
Centrelink advance	24.82%
Retail "interest free" deals	6.51%
Utility periodic payment	15.70%
Family and friends	17.85%
Pawn broking	8.42%

The 2011 Consumer Survey revealed that 17.78% of the total number of borrowers responding had access to other suppliers of credit.

The following summarises what the borrowers said, in descending order of frequency, to explain why they did not take advantage of that access:

Reason mainstream lender rejected	No. of borrowers
Convenience	53
Quick and easy	30
Existing lender/customer loyalty	28
Able to borrow the amount I wanted	23
Card to the limit/already borrowed elsewhere	22
Service	16
Affordable/cheaper	9
Interest rate similar	7
Lender friendly	6
Less paperwork/procedures	5
Comfortable dealing with lender	5
Already have a loan with lender	5
Other sources higher interest rates	5
Location of lender	4
Poor credit rating	3
Loan short term	3
Still paying off another source's loan	2
No re-draws permitted	1
Other source would not extend loan	1
Lender recommended	1
No loan available	1
Not able to continue loan with other lender	1
Higher interest rate elsewhere	1

It is significant to note that, of the 232 reasons given for not going to another source of loans, the breakdown of the most frequently expressed motives could be aggregated as follows:

% of borrowers	Reason mainstream lender rejected
22.8%	Convenience
36.4%	Service related
12.1%	Customer loyalty
9.9%	(Small) size and (short) length of loan
7.3%	Cost
9.5%	Borrowed to limit elsewhere
5.2%	Other reasons

Competitor Awareness

The consumer advocates allege that the majority of borrowers are subject to the interest fees and charges that the lenders present, in an environment without competition. This argument is not sustainable.

In support of this Submission, we draw the Committee's attention to the following research results indicating consumer awareness of lending competitors:

In the 2010 consumer study, 71% had taken out a loan with another lender of some kind. The proportion of those who had borrowed from another small amount, short term lender was - 15.9% one lender; 10.1% - two lenders; 2.4% - three lenders; and 0.9% four lenders or more.

In addition, 79.9% knew of at least one other lender, 68% knew of 2 other lenders and 28.7% knew of 3 or more other lenders.

In the 2007 national survey, only 23.4% had not borrowed from another lender, 38.3% had dealt with one other lender, 26.5% had borrowed from at least 2 other lenders and the remainder had borrowed from 3 or more lenders. A separate South Australian survey also conducted in that year revealed 53.9% had borrowed from at least 2 different lenders over the previous 2 years.

The 2007 South Australian survey revealed that 53.9% had borrowed from at least 2 different lenders in the last 2 years.

The lenders see price competition from a different perspective. In the 2010 Lenders' Survey, 98.5% of lenders believed that there was price competition in the marketplace, with 12.4% indicating that one of the two main reasons they lost customers - to any competitor - was because of the competitor's lower cost. This was the 4th most common reason stated. According to 19% of the lenders, the only reason that was more significant was 'convenience'.

The preparedness of consumers to try other sources of supply, is a highly relevant competitive pressure and 73% of the lender's management indicated that 4 or more competitors were relevant.

Smiles Turner's Microlenders' Survey 2010, indicated that 71.7% of total lending outlets reported 95% or more of their consumers were aware of at least one competitor offering similar loans. 8.3% of outlets reported that 90% of their consumers were similarly aware and the remaining 10% reported a 70% awareness. The assumption is that competition will include a focus on price. However, this does not reflect the microlending market environment. There may well be competition, it is just that, for the most part, it is not price related.

Lenders point to the numerous local and metropolitan newspaper advertisements placed by the microlenders and brokers, providing substantial opportunity for intending consumers to "ring around" and undertake a comparative price analysis. The two major suburban (free) newspaper groups in Sydney generally carry a minimum of three microfinance advertisements per issue and an extensive range of alternatives can be found in every metropolitan yellow pages.

In Smiles Turner's parallel Consumer Snapshot 2010 study, two interesting areas emerged indicating that the majority of consumers are aware of other options.

- 79.9% of consumers responding knew of at least 1 other short term lender.
- 68% knew of 2 other lenders.
- 28.7% knew of 3 or more.

In addition:

- 48% of respondents had previously been given a loan by a bank, building society or credit union
- 46.5%, at one stage, had a credit card, with nearly two thirds of these people continuing to carry one.

The issue for the consumer advocates to accept is that, no matter what the level of competition, there will always be a certain level of unescapable business costs which, in this case, exceed 48%.

Cost comparisons

It is relevant to note that the response to the question, "*Today, or whenever you last took out a loan, did you come here, or contact here to borrow, because there was nowhere else cheaper?*", elicited a "NO" response from 48.8% of the consumers responding to the Consumer Snapshot 2010 study.

Consumers do have the opportunity to compare lenders costs, as indicated by the following:

- 2010 CALC Report, pages 77-78, 41.5% of respondents indicated having more than one source of credit available.
- Smiles Turner 2006 Customer Survey - 28.39% had access to more than one source of credit.

The statistics on knowledge of another lender and previous borrowing history indicate that a significant number of consumers are aware of competitive pricing and/or have had the opportunity to make enquiries elsewhere.

The Smiles Turner Microlenders' Survey 2010 indicated that there is a range of awareness and interest in cost, for small amount, short term borrowers. The following table, with the top figures indicating the percentage of lenders involved who report the proportion of consumers, indicated in the line below, who demonstrate the relevant interest.

What percentage of your customers care what the cost of their loan is?						
Lenders	53% said	15% said	0.5% said	0.5% said	6% said	24% said
Consumers	0-5% care	6-10% care	20% care	40% care	50% care	70+ care

What percentage of your customers ask what the total cost of the loan is?					
Lenders	10% said	16.6% said	4.9% said	1% said	68.8% said
Consumers	none	1-20% ask	30% ask	60% ask	70%+ ask

What percentage of your customers ask for the cost before they make their decision to borrow from you?					
Lenders	72.7% said	19.5% said	0.5% said	1% said	6.3% said
Consumers	1-10% ask	30% ask	60% ask	70% ask	80%+ ask

Consumer price awareness

The Delegation is aware that consumer advocates attempt to maintain that borrowers are not conscious of price when they negotiate their loans. This is simply not true. There is also the issue of consumer perception, which may be very different to that of some observers who are not, themselves, micro-borrowers.

The Committee would be aware that there is a difference between knowledge and concern. Research conducted by Smiles Turner in 2003-4, amongst 10 Victorian microlenders, all with their prices clearly displayed in the foyer of their premises and included in their contracts, indicated 4 of the lenders reporting more than 90% of their customers not having any significant concerns about (borrowing) costs and the other 6 lenders reporting the same for between 35% and 45% of their customers.

In the November 2010 Smiles Turner Consumer Survey, exploring consumer price awareness, found that:

1. Question - Did you ask about costs, before you made up your mind to take out the loan? Yes - 88.4%
2. In regard to the cost of the loan - 4.3% thought it was "cheap", 60.6% thought it was "fair", 28.5% thought it was "a bit expensive" and 6.4% thought it was "very expensive".
3. In regard to the costs of unascertainable fees - 5.9% thought they were "cheap", 65.8% thought they were "fair", 20.2% thought they were "a bit expensive" and 6.4% thought they were "very expensive".
4. When asked how important the cost of the loan was in their decision to borrow - 6.4% said it was "not important", 64.4% said it was "important" and 23.8% said it was "very important". There was no response to this question by 5.4%.
5. When asked if cost influenced their decision to borrow from the lender they were seeing today, 47.03% said "Yes".
6. In regard to "fees and charges you might have to pay on your latest loan, if you fail to pay on time", the respondent's assessments were - "very expensive", 5.9%; "a bit expensive", 19.8%; "fair", 62.4% and "cheap", 6.3%.

The 2011 Survey revealed:

- 93% of respondents said they had worked out what they could afford to borrow, before committing themselves to a loan.

- When asked how important the cost of the loan was to them, the response was: "Very important" - 43.9%; "important" - 47.4%; "Not important" - 7.3%, with 78.7% saying they looked at the total cost of the loan when choosing.
- 76.9% regarded the cost of the loan as "fair", 7.9% thought it was "cheap" and only 13.1% thought it was "expensive", or "very expensive".
- Similarly, when asked what they thought of the unascertainable costs, 80.2% thought that they were "cheap" or "fair".

The lenders in the 2010 Survey responded with 65.9% reporting that at least 35.5% of their consumers <u>were</u> influenced by the cost of credit and 35% of outlets reported that, in their assessment, approximately 50% of their consumers were influenced by costs. All the above suggests that the majority of borrowers are aware of the price they pay.

Consumer concerns

Given the above, and the strong support for the current Bill's provision demanding contact details for alternative low credit sources being included on lender and broker websites, it is interesting to note the impact of having warnings included in current credit contract documentation, which alerts consumers to the fact that their intended loan is relatively expensive.

As discussed below, this concept is already supported by many lenders. The following statistics demonstrate this point, but also alert the Committee to consumer behaviour, which might lead consumers to gain less benefit for notices on websites and warnings in contract documentation, than supporters of both would expect.

- 2010 research indicates 79% approval, by lending companies, of such warnings being made compulsory.
- Microlenders' survey 2011, indicated 77.6% of outlets said they already had a warning.
- 41% of the 2011 Consumer respondents indicated that their contracts already contained "*a warning that your credit may be high priced compared to other sources*".
- 89% of Min-It Software's and all Smiles Turner's compliance clients already have such a warning included in their contract documentation.
- In the 2010 Smiles Turner research, 99% of consumers replied "yes" to the following question, "*Today, or whenever you last took out a loan, was the total cost of your loan fully explained to your satisfaction?*".

However, for the consumer advocates and others, who see the compulsory website listing as important, it must be noted that the 2010 Consumer research revealed <u>only</u> 24.4% respondents replied "yes" to the question, "*Did you read every document given or shown to you?*".

Supporting this low readership level are statistics from the Smiles Turner Australian Law Reform Privacy Survey, April 2007, which provided the lenders' assessment in regard to the mandatory Privacy Protection of Information Statement and Declaration. The Committee is advised that this 2007 survey was at a time when the total documentation provided to consumers was at least 30% less than is now required. For what might be considered a less important document, the participating companies, with their 460 outlets, responded to the question, "*What percentage of your customers read this document before they take out their loan?*", as follows:

12.4% outlets said none of their customers read the document	5.4% outlets reported 1% of customers reading the document	0.4% outlets reported 3% of customers reading the document	5.7% outlets reported 5% of customers reading the document
25% outlets reported 10% of customers reading the document	1.1% outlets reported 20% of customers reading the document	0.2% outlets reported 40% of customers reading the document	0.9% outlets reported 60% of customers reading the document
4.4% outlets reported 70% of customers reading the document	2.2% outlets reported 80% of customers reading the document	0.2% outlets reported 95% of customers reading the document	0.6% outlets reported 100% of customers reading the document

Impact of cost reduction

One of the major aims attributed to the current Bill is that it will reduce the cost of borrowing.

Putting aside the issue of whether or not there will be any company left from which to borrow, it is interesting to note that borrowers responding to the Smiles Turner Consumer Snapshot 2010 study were asked two questions to explore price sensitivity. The first was "*Would you borrow more often if loans were cheaper?*". 27.7% responded "NO". The second question asked whether or not they would borrow less if loans were dearer than they are today. 30.7% indicated that there would be no change in their borrowing habits.

Opportunity cost matters

During the various consumer research programs, consumers provided comment on their loss if a microloan had not been available. While no attempt appears to have been made to assess such qualitative matters, by any researcher supporting the current Bill, the range of informal comments collected during three consumer research programs (2007, 2010, 2011), indicated significant consumer understanding, awareness and motivation to avoid high opportunity costs incurred by not taking out a loan. This including the recognition of consequent financial inconvenience and/or loss and the distress or psychological harm suffered for the sake of saving the cost of the loan. Three actual customer examples, provided by the consumer during each survey, illustrate this point:

- the plumber with the broken down utility, unable to service his clients (2007, Vic)
- the family who want to maintain a 100% house rental payment record, in a very tight rental market (2010, NSW)
- a mother working as a nursing sister, with a temporary financial setback, deprived of the opportunity to give her daughter a birthday party and present without access to the micro-loan (2011, Queensland).

Consumers appear to consider the real opportunity cost to them if they do not obtain the credit. For instance, in 2010 up to 42.35% of the reasons given for borrowing could be considered emergencies, which implies a high opportunity cost, generally of a financial and significant nature, if the loan was not provided. Opportunity costs, including late payment fees and reports of non-payment on the consumer's credit reference file, should not be overlooked. On the other hand, there were reasons such as Christmas, birthday, funeral, school uniforms and the like, which added up to a total of 10.25%. With these, the opportunity cost could be largely psychological.

It is a reasonable presumption to consider that the negative emotional impact of not satisfying these demands would have been more traumatic than the impact of the financial cost.

Centrelink Benefit Recipients and Borrowing

The proportion of borrowers of small amount, short term loans who are Centrelink benefit recipients is an issue of considerable interest.

In 2006, Smiles Turner Industry Analysis, Customer and Loan Information Surveys conducted a survey of 122 lending outlets, involving the loan application forms of over 4,000 borrowers. Excluding FTB payments, these surveys revealed 49.9% of customers were employed full time (with a range, between the respondent lenders, of 10% to 98%), 24.4% derived income from employment and welfare payments combined (with a range of between 5% and 45% between the respondent lenders), and 25.7% derived income from welfare payments only.

Of those customers who were employed, the proportion with full time jobs was 57.5%, with a range, between lenders, of between 10% and 100%.

While 6 of the 32 responding companies did not keep easily accessible statistics on the types of jobs the employed borrowers had, the remainder indicated an average of 76.6% of those employed constituted "unskilled/semi-skilled, e.g. labourers, truck drivers, cleaners etc." and "Trading persons, e.g. carpenters, hairdressers, salespersons, etc."

The proportion of such employees, between the 25 respondent companies that did keep statistics, was between 60% and 98%.

In 2007 Smiles Turner research indicated 22.84% of consumers derived their income entirely from Centrelink benefits, 27.38% derived their income from a mix of employment and welfare and 49.78% derived their income entirely from employment.

In May 2010, the NAB Small Loans Program published its quarterly report concerning Fast Money loan products (between $1,000 and $5,000, with average of $3,414) and, in regard to their demographic profile noted that, in January-February, 27% of total applicants and 19% of those applicants who were successful, received government benefits. The figures for March were 36% and 20% respectively.

The 2007 research results were almost duplicated by the results of the April 2011 consumer survey. In that survey, consumers receiving any form of Centrelink benefit (with or without other sources of income) numbered 48.73%.

The September 2011 Smiles Turner industry research revealed that the respondents had an average of 33% of their consumers receiving some form of Centrelink benefit.

The Delegation does not deny that a proportion of Centrelink beneficiaries, without any other source of income, are inappropriate to lend to on a commercial basis. However, there are tens of thousands of Centrelink beneficiaries who borrow from commercial lenders and/or apply for Centrelink advances and/or ask for time to pay their utility bills, who successfully manage their tight finances. Media reports indicate over a third of the Australian adult population receives some form of Centrelink benefit. While the under 10,000 people that the consumer advocates have identified as having financial problems (not necessarily because of commercial small amount, short term loans) have to be recognised, so does the proportion that number represents to the millions who receive a Centrelink benefit.

Consumer Complaints

It must be noted that, Australia wide, a minimal complaints about an industry sector besieged by regulation and philosophically driven consumer advocates, clearly suggests that the services and products provided by the microlending industry are understood and required by consumers.

The Delegation notes a continuing attempt, by consumer advocates, to imply that there are many complaints and that there would be more, except consumers are reluctant to make a complaint. As presented to the Joint Committee in evidence by consumer advocates and without any research to support the assertion, it is claimed that consumers are reluctant to complain for fear of getting the lender offside and because the amounts involved are relatively small.

Notwithstanding that this implies a concern, on the part of consumers, to maintain the opportunity to borrow from the commercial lender, this assertion reveals that the witness has not had any contact with lender counter staff, who would have quickly told her that most consumers have little reluctance in raising a complaint to the staff.

Such a view also pre-dates the mandatory Internal Dispute Resolution/External Dispute Resolution provisions now in place.

The incidence of relatively low complaints is not a new phenomena. In 2006, Smiles Turner conducted a survey of microlenders in NSW. 63 lending outlets were asked about consumer complaints and the results were as follows:

Question to 63 lending outlets	Total Occurrence
Inclusion in Office of Fair Trading Top Ten	Never
Total number of complaints to the OFT in 2006	3
Number of complaints to OFT leading to prosecution	Nil
Average no. of complaints over lenders' total operational years	1 per 13 years, or 0.406 per company

In 2006, one lender was taken to court by a consumer, with a consequent out of court settlement.

The same issue was researched in 2007. In that year, for all 32 lenders who responded, a number of whom with multiple outlets, one complaint was lodged with a government office against one lender and 2 against another.

Over a total of 123 years that the companies had been in business, 9 complaints had been lodged, averaging 1 complaint every 13 years and 9 months. In 2007, one Office of Fair Trading took one of the lenders to court.

In 2008, no complaint to a government office ended in a prosecution and the one dispute ending up in court was initiated by the lender. In this period and since, payday and microlending have not made the top 10 listing (for complaints) published by each state and territory's Offices of Fair Trading/Consumer Affairs.

Smiles Turner research and industry analysis, over the last decade, reveals that the majority of lenders have never had to appear before any state tribunal or court on a matter involving microlending and those who have appeared on other matters, have done so on only a handful of occasions.

Complaint misconceptions

The Delegation was reminded of the misconceptions concerning consumer complaints, when considering the evidence provided by COSL and Queensland Legal Aid witnesses at the Joint Committee hearing on the 24th October 2011.

The Legal Aid representative expressed a concern that many disputes in which she had been involved, over several years, had ended in settlement. Although not being able to provided exact numbers to the Committee, this was obviously a matter of concern to the witness. Her evidence included mention of only one case, in her many years as a consumer law solicitor, actually going before a court and gave no explanation as to why the case was settled.

Significantly, the witness was referring to a period prior to the introduction of the mandatory IDR and EDR regime, commencing 1 July 2010.

The Delegation takes the view that this preparedness to settle, by the industry and by the Legal Aid clients, would indicate a preparedness to compromise, generosity on the part of the lenders and the relatively small amount involved not justifying expensive litigation.

EDR complaints

The evidence of Mr Raj Venga, Ombudsman, Credit Ombudsman Service Ltd (COSL) before the Joint Committee on Corporations and Financial Services on 24 October 2011, deserves the Committee's closest attention. As the major External Dispute Resolution Service for Australian small amount, short term lenders, this organisation has 1,000 of its 7,000 members in that category.

Mr Venga reported on the first year of the Commonwealth's consumer credit protection regime (1 July 2010 to 1 July 2011).

The lenders of concern to the Committee generated 5.4% of the total number of complaints received by COSL in that 12 month period. There was a total of 114 complaints, which constituted an average of a little over 2 complaints per week, from 1,000 members who issued approximately 1.5 million contracts for the year, i.e. 30,769 per week.

Considering the detail provided by the witness, it may well be that only 50 of these complaints were within the ambit of the provisions in the current Bill. Therefore the current Bill addresses an issue of concern that emerged just once per week, on average, for the 12 months involved.

The statistics Mr Venga provided demonstrate that these 114 complaints did not come from a wide cross section of lenders. 59 (52%) involved 5 of the largest lenders (average 5.2 complaints each), 54 (48%) involved 38 other lenders with "*less than 3 complaints each*" (average 1.42 complaints each). Just 43 lenders were involved, but not necessarily "guilty" as Mr Venga's statistics demonstrated, with just 30% of the complaints decided in favour of the borrower.

The Delegation notes that, while no company names were provided if, for discussion purposes only, you were to assume the biggest lender, Cash Converters, was one of the 5 largest companies involved, the average 5.2 complaints for a total of 12 months must be compared to a loan volume in excess of 800,000 for the same period.

It is useful to note that COSL “closed” 94 complaints, 55% of these were not resolved in favour of the borrower and 25% were resolved “*partly in favour of the borrower*”.

50 of the complaints appear to come within the ambit of the current Bill. The break down provided by Mr Venga was as follows:

Category	**No. of Complaints**	**Percentage total complaints**
All categories	114	100%
Hardship	18	16%
“*Imprudent lending*” (not responsible)	14	12.5%
Fees too high	12	11%
Interest rate too high	6	5%
Total possibly relevant to current Bill	50	44.5%

In a response to a request by the Joint Committee, at their hearing on 24 October 2010, COSL provided further information on 27 October 2010.

1. The average loan amount was $1,663, which would imply that most of the complaints received were not about payday loans, but about microloans.
2. The distribution of the complaints by jurisdiction, with the possible exception of Western Australia and Tasmania, significantly reflects the relative size of the volume of business in each jurisdiction. Remembering that we are only dealing with 114 complaints and that 9 percentage categories are fairly meaningless with such a small number - the 33.3% (37) each from NSW and Queensland and the 21.1% (24) from Victoria reflect the greater concentration of lenders and the greater volume of business in those jurisdictions, given population size. The Delegation is unaware of the spread of COSL memberships for lenders across Australia, which may also be an influence.

   The Delegation would not be easily convinced that the higher proportion from the states with an existing interest rate cap had any major significance, given the issues of relative population density and volume of business.
3. The detail provided on types of complaints and the 130 issues raised by the 114 complaints is of interest. In regard to matters addressed by the current Bill, 21 issues involved some aspect of hardship, 8 involved fees being excessive and 6 involved interest rates claimed to be too high.

This provides a total of 35, being 26.9% of all issues. Remembering that only 30% of complaints were decided in the consumer’s favour. That means, by a very approximate extrapolation, something like 12 of all the issues raised - being 9% of total issues - were considered in the consumer’s favour and 9 (7%) were considered partially in the consumer’s favour. These results do not lend support for the current Bill.

The September 2011 Smiles Turner industry survey revealed that, amongst the 19 lenders providing information, there had been 13 complaints to COSL. One lender had 3 and the other lenders with a complaint had one only. The average for the group was 0.68 per lending company, with 49 outlets and offices involved, the complaint ratio was 0.27 per outlet. There were no court cases initiated by either the borrower or the lender.

The current Bill’s very complex options are set for possible introduction into a lending environment which generated only 114 lodged complaints with COSL, the major External Dispute Resolution service provider to the small amount, short term loan sector, for the whole of Australia for the 12 months to July 30th 2011, with 94 being resolved.

Despite every set of contractual and associated documents issued by every lender including multi-listing of contact details, and the fact that the service was free to consumers, this complaint number to COSL constitutes just 0.005% of all loans issued during that year.

The Delegation contacted the Financial Ombudsman Service (FOS), but the Service was unable to provide similar categories of statistics. It may be useful to note that, while this service has a greater number of total members than COSL, it is known to have far fewer small amount, short term lenders as members.

Complaints and hardship - two case studies

During 2011 the performance of two companies came to the Delegation's attention - one a major lender with company owned outlets in three states and an internet presence, and the other operating two Sydney suburban stores and a relatively small internet lending facility. Both companies were included in ASIC's general review of payday lending and documentation across Australia (we emphasise, not because of any complaint). Neither had come to the attention of ASIC before, or since.

Cash Stop

During the first 6 months of 2011, ASIC approached Cash Stop Management and asked for all contracts from 1 nominated NSW (typical for the company) retail outlet for the last 3 months. As a result of that request, copies of 824 contracts and files were provided to ASIC.

The audit of those contracts and files revealed:

- No complaints for Internal Dispute Resolution or External Dispute Resolution (COSL);
- 2 customers made hardship applications;
- 65 asked for one payment extension;
- 12 asked for a new payment plan;

The other 745 (90.4%) completed their repayments according to their original contract terms.

The new payment plans were requested for the following reasons:

- 5 - change of pay;
- 3 - unexpected or urgent bill;
- 1 - change of account;
- 1 - son's dental bills;
- 1 - overdue account; and
- 1 - lost job.

Money Centre - Dee Why and Hurstville (Sydney)

In an analysis for ASIC, Management undertook a review of complaints for the 12 months ended 1 July 2011. Involving thousands of contracts (details withheld for commercial confidentiality) the following breakdown was established:

1. Over the counter complaints:

   140 due to NAB payment system crashing;

   445 due to returning consumers having to supply all documentation every 90 days for a new assessment (mandatory under the National Consumer Credit Protection Act);

   20 as a result of being deemed unsuitable and claiming that the company did not trust them;

   10 - high fees charged; and

   80 due to the claimed long processing time associated with the mandatory application and assessment process, generally because they had taken time off work to come and apply for their loan and wanted to get back to work.

2. Complaints referred to the IDR Manager:

   1 where the consumer had his complaint referred back by COSL, after he had failed to notify the company and gone straight to COSL seeking direct debits to stop while he was in hospital (extended term granted).

3. EDR (COSL):

   1 being the person who was referred back to the company's IDR Manager.

Industry maturity

A review of lenders' websites and product offerings reveals a wide variety of products, offered at varying terms and amounts. While some websites do not present current prices, the opportunity to enquire is always very easy. This is evidence of an efficiently functioning market.

All the above indicates a substantial consumer awareness of costs and competition in a payday and microlending market that, apart from the hiccup caused by Commonwealth regulatory uncertainly over the last 18 months, is fast reaching a state of maturity where price awareness and intense competition can be expected as the norm, if the necessary changes are made to the current Bill.

A further indication of industry maturation is this group of borrowers' demonstration of financial responsibility and independence, with a growing number of them falling into an emerging category identified by Veda Advantage earlier this year. In that company's analysis, a growing number of borrowers were amongst a group who could access credit from mainstream providers, but chose to access from microlenders, recognising actual and perceived superior service levels. An analysis of one lender's consumer base, admittedly involving many consumers who borrow in excess of $3,000, had the percentage in this category as 43%.

We acknowledge that this is a particularly high assessment and that the recently released RMIT University report *"Caught $hort - Exploring the Role of Small Short Term Loans in the Lives of Australians"* (August 2011) indicates that the percentage of payday and micro-borrowers who were able to access mainstream finance, amongst its 112 respondents, was 7%.

Consumer intentions (fraud)

Lenders are somewhat frustrated that little attention is paid to the behaviour of the consumer. This is unfortunate because there are issues that should be included in the equation, including those consumers borrowing with fraudulent intent.

The 27 lender, October 2011 research panel were asked, "*This year, how many people have taken out a loan with your company, with no apparent intention (as discovered later) to pay anything back?*".

The responses <u>for the 4 months</u> were:

Number of consumers with no intention to pay back the loan	Number of lenders who suffered this
0	3
1	2
2	4
3	1
5	4
6	1
8	1
10	2
14	1
16	1
30	1
76	1
112	1
Don't know	3

In percentage terms, it is interesting to note the variation according to lender type:

- one major Internet lender reported 3.8% of the total loans advanced were taken out by people who never intended to fulfil their contractual repayment commitments;
- small lenders reported a range of consumers in that fraud category - 0.005%, 0.52%, 0.85% and 5%;
- a medium to large retail lender reported 2% of total consumers defrauding.

While the Delegation accepts that the proportion of consumers who defraud will be influenced by the lending policies and marketing strategies adopted by the individual lender, it is useful to note that only 3 (all small and conservative lenders) reported that no one, over the last 4 months, deliberately defrauded them.

The comments included in the responses of 4 small lenders, 2 medium lenders and one large lender research panel member, may be of interest to the Committee. When asked "*This year, how many people have taken out a loan with your company with no apparent intention (as discovered later) to pay anything back?*":

Small lender #1:

"*One idiot who took out a $2,000 (loan) and had either already filed for, or entered into a Part 9 Debt Agreement soon after. We never received even one payment and there was absolutely nothing we could do about it*".

Small lender #2:

"*We have become extremely conservative given our experiences with the sheer number of individuals and operating groups that actively seek to defraud lenders and have 'black-banned' a number of high risk demographic groups (following 'hard-earned' experience). Such behaviour is not limited to semi-professional rackets but also extends to some individuals attempting to use another family member's ID. We operate in an extremely high risk arena with no advocates or groups protecting our interests. We have found that even in instances where we have been defrauded by intent; a criminal act, even with substantive evidence, the Police refuse to take a report or make it extremely difficult and simply advise that any report will not be progressed or investigated in any manner".*

Small lender #3:

"*Perhaps 10. This includes 2 who immediately sought protection of a Part 9 agreement, despite making no attempt to make any payments at all. ITSA should protect us from that*".

Small lender #4:

"*We average 6-7 per week with deliberate intent not to pay anything back, they simply stop DDR or close* (their) *a/c, or withdraw all money & then continue to default deliberately*".

Medium lender #1:

"*Can be as much as 20%. For this and other reasons I only lend to people who work and have reduced my fees, as my risk is less as I can garnishee wages to recover bad debts*".

Medium lender #2

"*…it would be in the order of 50 at least*".

Large lender:

"*There are …a reasonable number of consumers, slightly biased to Benefit recipients, who have never made a payment on a loan instalment and never react to collection call/activity, as they clearly know that no court (if it was to get that far) would ever rule against them …their benefit cannot be garnisheed and many say 'default me I don't care'… they never have any aspirations of joining mainstream and getting a job, so they know they can just hide behind the "system" and bludge off taxpayers and credit providers for the rest of their days"*.

Consumers and information disclosure

The Australian Law Reform Privacy survey in 2007 revealed that 69.6% of outlets believe that it would be too difficult "*to get all the necessary credit history information about a person applying for credit, in order to fully assess the risk of providing the loan*".

Associated with that, 31.1% of the outlets regarded compliance with the still unchanged Privacy laws a burden.

It must be noted that the minority of consumers are reluctant to give their financial details to the lender when applying for a loan.

What percentage of your customers are reluctant to give their financial details to you when applying for a loan?		
43.7% of outlets said 0%	24.3% of outlets said 1%	23.9% of outlets said 2%
4.8% of outlets said 5%	1.7% of outlets said 10%	0.7% of outlets said 20%
0.4% of outlets said 25%	0.2% of outlets said 30%	0.2% of outlets said 50%

Rejection rates

Smiles Turner's 2007 Industry Analysis Survey, involving 32 companies, indicated rejection rates varying from 10% to 90% of total applicants and the average for the companies responding was 46.58%, with 70.77% of all outlets rejecting 50% or more of the applicants.

In the 2010 lender survey, 50% of companies rejected 50% or more of applicants.

The September 2011 Smiles Turner survey, with 19 companies responding, indicated rejection rates as follows:

1-10	11-20	21-30	31-40	41-50	51-60	61-70	71-80	81-90	91-100
1	1	4	1	2	3	2	1	3	1

The average for all companies was 52%.

Lenders appearing before the Joint Committee as witnesses, commented about their company's rejection rates, either during or after the hearings, as follows:

- A medium sized lending firm, with 3 retail outlets, rejects 2,000 applicants per month.
- A major internationally owned internet lender, who lends only to the employed, reports rejection rates of generally 1 in 6. Then, from those who were successful, rejects 1 in 3 who are employed and who seek a loan.
- A major telephone lender reports rejection rates currently running at 90%.

The Delegation advises that some allowance must be made for those people who attempt an application just "to give it a go". Their legitimacy must be questioned when they quickly disengage as soon as they are asked for proof of identification or financial information. Anecdotal evidence indicates this issue is particularly relevant for phone and Internet lenders, but Smiles Turner is unable to provide statistical evidence.

What happens to those people who are rejected?

Unfortunately, Smiles Turner research has never focused on those rejected and where they go, but a possible indication of what might happen to them can be found in the responses to questions presented to all potential consumers who entered retail (bricks and mortar) lending outlets, or contacted participating internet and telephone lenders.

Segmentation between those who were successful and those who were rejected on the day they completed their questionnaire, was not attempted. However, while the following results take into account both segments, treating them as "potential borrowers" in the absence of directly related research, Smiles Turner assumes the results will provide a broad indication of what occurs.

It must be noted that the results indicate the untested alternative that might be adopted by the consumer - it presumes that this alternative would actually be available to the particular consumer now and in the future when, following the abolition of payday and microlending as a consequence of the current Bill becoming law. However, it is highly unlikely respondents had those thoughts in mind. Therefore, it is important to consider the possible impost of the 2013 circumstances, when that consumer will have to compete with 750,000 other consumers seeking an alternative source of credit.

As the statistics reveal, the majority of consumers responding could not identify a legal alternative to payday and microlenders - that they would be able to access.

The following are the research results from 2006-7 to the question "*If the lender you are seeing today and all lenders like them were closed down by a new government law, what would you do?*"

Where a legal alternative is actually identified - a bank, credit cards or pawn brokers - the proportion of borrowers hopeful of accessing these alternatives was:

	NSW	SA	Qld	WA
In 2006-7	17.2%	6.9%	7.3%	10.2%

In the South Australian 2007 survey, 553 consumers were asked:

If lenders like this all closed down, where would you go when you needed money?	
Don't know	68.4%
Nowhere to go	10.8%
Friends	4.0%
Family	3.7%
Banks	3.4%
Pawn brokers	2.2%
Maximise their credit card	1.1%

One or two people each listed the Salvation Army, Government, suicide and crime, but no one mentioned any other non-commercial source of finance.

In November 2010, of the 441 consumer respondents, the Australia-wide percentage of consumers indicating their hopes of accessing a bank, credit cards or a pawn broker if the industry was shut down, was 11.3%, 0.3% and 0.5% respectively.

Only 0.3% indicated they would turn to a charity and 0.9% said they would go to Centrelink. 9.2% said they would turn to friends and family and 70.49% indicated they had nowhere else to go.

The Delegation's October 2011 research panel of 27 lenders, from every part of the small amount, short term lending sector, provided a further insight into this issue from their current experience as lenders. Collectively, their responses to the question "*In your opinion, or to your knowledge, what happens to those people you reject for a loan?*" were as follows:

1. Many continue to see lender after lender - a cascade effect; finally attempting to borrow from a less documented or more expensive lender. Note this is adverse for their credit file, because shopping around generates numerous credit enquiries on their credit file.
2. They sell their property, turn to break and enter crime and shoplift at the major grocery supermarkets.
3. Friends or family and then pawn goods.
4. They go without.
5. Use pawn brokers.
6. They will use unlicensed lenders.
7. One lender reported a practice of referring them to debt management companies, where the circumstances seemed appropriate.
8. One lender reported a practice of encouraging co-borrowing, where a consumer marginally failed to qualify on application and the security of a financially more secure co-borrower overcame that failure.
9. One retail lender, with three outlets plus internet lending, reported rejecting 2,000 applicants a month, with 50% of applicants not meeting any responsible lending criteria.

The Delegation notes that not one lender mentioned that the rejected consumers would go to a NILS or LILS scheme, or a charity.

Pawn broking

Pawnbrokers in contact with Smiles Turner during the preparation of this Submission, reported the following phenomena:

1. A growing number of people are approaching pawn brokers with expensive mobile phones to pawn. They take out a plan with a Telco, involving as expensive a phone as they can get, and then proceed to immediately pawn it or, if refused, to sell it at the local hotel.
2. Many seeking to pawn now do so with no intention of redeeming the pawn. The traditional pawn broker will lend a modest amount and the customer will redeem the pledged or pawned item at the end of the period, paying something like 30% flat per month. The approach of offering the modest amount generates an approximately 80% redeem rate.
3. Those pawn brokers offering more than a modest amount rely on a major retail presence to sell off their unredeemed stock. Consequently, major pawn brokers with a high retail location presence will accommodate a 50% redemption rate, making a considerable part of their income from retail sales.

Pawn broking in the future

1. Except in the case of items such as good jewellery, the growing problems are that the retail value of second hand goods continues to decline in the face of falling prices for new goods, relative to the price of the same item when originally introduced onto the market, and the obsolescence that occurs with ever faster new model release cycles.
2. The results, for those now choosing pawn brokers instead of lenders and for those who will choose to pawn items when the current Bill, if unamended, effectively abolishes small amount, short term lenders, will be:
    - a continuing (real) fall in the pawned value of their goods for pawning;
    - after the Bill commences as an Act, having to compete with a flood of new people who have never before considered pawning their goods;
    - the need to obtain as much money as possible from a pawn broker, for each item pawned;
    - this leading them to having fewer and fewer possessions, as they choose not to redeem their property because they consider it uneconomic in their circumstances to pay the pawnbroker's 30% per month (it should be noted that this is a flat rate and is repeated month after month, until the property is redeemed or sold. That makes a pawn broker's APR very significantly higher than the 48%).

The Delegation asks - if the current Bill becomes law unamended, what happens to the people who turn to pawning their goods when they run out of goods to pawn?

The consumer advocates have no researched information to offer on pawn broking.

Smiles Turner's research on consumers and pawn broking is limited to the responses from small amount, short term consumers in the 2006-7 and 2010 surveys, where a range of 1.4% (2011 survey) to 2.2% (2007 survey) said they would attempt to turn to pawn brokers for finance, if the payday and microlenders were abolished. In 2010, the figure was 0.5% of respondents.

The problem with these findings is that the research did not embrace any consideration of past experience with pawning, how many portable goods they actually had to pawn, or the likely value of those goods, as assessed by the pawn brokers.

Cash Converters, currently engaged in a vigorous and expensive lobbying campaign to save its 40% dominance of the Australian payday lending market, obviously does not consider its substantial network of pawn broking franchisees and company outlets as being able to absorb credit contract borrowers moving to pawning, post-1 January 2013.

The Delegation is unable to advise the Committee on how long these people could expect to rely on pawn broking for their small amount, short term credit needs, but it is anticipated that this opportunity could be relatively short term, in comparison with the current continuing availability of unsecured small amount, short term borrowing. The element of increasing poverty, measured by fewer and fewer portable possessions until there is nothing left to pawn, must be considered a significant issue.

The Delegation is concerned that the many issues associated with consumers and pawn broking be thoroughly explored, as part of the Minister's promised Discussion Paper process on alternatives to commercial payday and microlending.

SECTION 9

Small Amount, Short Term Lending - A Social Need

This Section considers the views of significant third parties in relation to the need for commercial small amount, short term credit, within Australian society.

The Social Need for Short Term Loan Availability

Given that the current Bill effectively abolishes most small amount, short term lending, the Delegation would argue that it effectively ignores the social need for credit. Small amount, short term lending cannot only be considered from the point of view of a person who has never had to go beyond borrowing from a friend, family member or credit card institution, when they have been "a bit short of money".

The Committee is invited to put themselves in the position of people who do not have easy access to mainstream sources of funds, including those in the low and middle income brackets. Such people should not be denied access to a legitimate source of lending.

In regard to low income earners, as previously discussed, both a Federal Government and a welfare agency report makes this clear.

"For a poor person credit is often a necessity. Even basic goods and services may be beyond the immediate reach of low income earners, especially those suffering unexpected misfortune such as illness or unemployment".

...1975, Professor Ronald Sackville, Australian Federal Government Commission of Enquiry into Poverty, page 104.

This was supported by a Paper written in 2004, which revealed:

"Historically, governments have used mandatory interest rate ceilings to address these kinds of concerns. Currently, about 40 developing and transitional countries have interest rate ceilings of some kind. Unfortunately, this often hurts rather than protects the most vulnerable by shrinking poor people's access to financial services. Interest rate ceilings make it difficult or impossible for formal and semi-formal microlenders to cover their costs, driving them out of the market (or keeping them from entering in the first place). Poor clients are either left with no access to financial services or must revert to informal credit markets (such as local moneylenders), which are even more expensive."

...Brigit Helms and Xavier Reille, "*Interest Rate Ceilings and Microfinance: The Story So Far: Building financial services for the poor*", Consultative Group to Assist the Poor (CGAP), Occasional Paper No. 9, September, 2004; Introduction. Website: www.cgap.org.

In its 2007 paper "*Ensuring a Responsible Credit Market: Principles of Responsible Credit*", the European Coalition for Responsible Credit noted, as the first point at Section B. "*Principles for Responsible Lending*", P1(a), that:

"In the industrialized society credit has become a service essential for full participation in society. By giving people access to their own future income, credit provides the opportunity to obtain the use of advanced goods and services that require capital investments like cars, household appliances, permanent education or homeownership. Access to credit makes it possible to bridge variations in income and expenditure and thus provide the flexibility that modern labour markets require.

...To this extent, credit has to be accessible for people in society irrespective of their social, biological, or cultural differences."

This social need is also recognised by two recent academic studies. In a paper published in the Journal of Financial Economics, October 2011, written by Dr Adair Morse, Assistant Professor of Finance, Booth School of Business, University of Chicago, entitled "*Payday Lenders: Heroes or Villains*", Dr Morse demonstrated that "*Payday lending seems to offer those in distress with an option to weather financial distress. ...access to finance can be welfare improving, even at 400% APR. ...welfare-improvement comes from the mitigating role of payday lenders following shock-driven distress."*

In addition, P S Stoianovici and M T Maloney, in their 2008 paper, "*Restrictions on Credit: A Public Policy Analysis of Payday Lending*" (Clemson, South Carolina), asserted that payday loans enable people to survive income interruptions and unexpected expenses.

In this context it is useful to note:

(a) Protection of consumers and caps are not necessarily synonymous. As the NCCP Act 90 Day assessment rules indicate, screening for suitability/unsuitability is the most important protection lenders can offer. Further, it must be understood that <u>lenders have no interest in lending to consumers who cannot afford to pay back their loan</u>. As both the State/Territory Uniform Credit Codes in the past and the current National Credit Code have demonstrated, disclosure is also a fundamental protection of consumers, plus control of the administration of the loans.

(b) It is recognised that proof of a breach of a finite measure, such as a 48% inclusive cap (allowing no market driven fees and charges), is easier than a more indefinite description in words - but what use is that when the finite measure being imposed is fundamentally unsound and will close down the availability of loans from legal lenders. There will be no breaches to prosecute when you cannot find the lender to prosecute and/or the consumer is too terrified to complain or give evidence against their legal source of credit.

(c) "*Vulnerable and desperate*" consumers will attempt to borrow when they cannot afford to, but it must be remembered that the lender now has to demonstrate comprehensive responsibility in their assessment procedures, face ASIC with its powers to challenge a contract as unjust, or face ASIC employing the unfair contract terms now in the ASIC Act. On top of this regulatory shield is the fact that defaulting loans cost lenders money and derive them of funds to re-lend. Consumer advocates find it hard to understand that lenders are not in business to lend to people who will never repay. Responsible lenders regularly refer these "*desperate*" people to non-commercial sources of help.

Smiles Turner 2010 research indicates 84.6% of lenders already "*encourage customers to see a financial counsellor... when the occasion appears to warrant it*". However, 82% of those lenders did not think it would be easy to encourage consumers "*to make greater use of financial counsellors*".

In response to the question, "*What percentage of those* (consumers) *you are/could encourage do you think would actually go and see a financial counsellor*". The answers were: 18% of lenders said nil; 53.9% said 1-5% of consumers encouraged and the rest indicated between 7.5% and 20% of consumers would actually go to the counsellor.

(d) Competition has a place to play in keeping costs down. Unfortunately, the regulatory uncertainties of the last 2 years have substantially discouraged new entrants, just when the industry sector was heading for a position of market maturity and significant lender competition. Notwithstanding this, the industry facts demonstrate:

- You cannot drive interest rates, fees and charges down below break even and expect lenders to stay in business.
- Lenders expect a certain level of profit on their charges, or it would be more attractive to look at other non-finance business opportunities.
- There will always be some lenders who will attempt to charge more than the industry 'norm'. However, if the consumers that approach them just do an internet search, look at the appropriate section in the 'Yellow Pages', or look in the appropriate section of every free local paper and all metropolitan and most regional daily newspapers, they will see plenty of choice being offered from plenty of lenders. No one need pay interest rates "*in excess of 1,000 per cent*", if they are suitable for a loan.

The imposition of unsound interest rate caps will simply lead to one or more of the following, some of which has already been experienced in NSW, Queensland and the ACT:

(a) Substantial investment in legal advice, sometimes sourced from the same major law firms who have advised government on the introduction of the interest rate caps and other credit regulation. This advice is on how to legally avoid the caps imposed; and/or

(b) the regulators' encouragement of a culture of avoidance of the general tenure or aims and objectives of legislation and regulation, as presented by the relevant Ministers' well intentioned, but uninformed, public and parliamentary statements. This with an obsessive focus on the detail and minute interpretation of the legislation and regulation, which can only ultimately lead to thousands of hours of public servants' time being consumed, the substantial enrichment of the big law firms advising the government sector and what should have been totally unnecessary court and tribunal applications; and/or

(c) substantial costs and competitive disadvantage suffered by those participants in the microlending segment of the finance industry who genuinely attempt to embrace the general aims and objectives of the legislation and regulation, only to discover the less scrupulous, or more ruthlessly professionally advised participants, are apparently legally embracing less costly and more marketable business models; and/or

(d) the introduction of an environment where a conservative interpretation of the legislation and regulation, together with adherence to the wishes of the consumer advocates - never borrowers themselves, never visiting microlending participants to actually observe the realities, and personally financially secure with their taxpayer funded jobs - would lead to certain business insolvency and personal bankruptcy for the industry participants; and/or

(e) prosecution and/or the imposition of fines and controls of the smaller participants in the industry segment, by compliance authorities who generally do not require court applications because the smaller participants are 'easy pickings' for compliance authorities. The larger companies seem to receive considerably more careful treatment; and/or

(f) the growth in opportunity for illegal lending totally outside the 'system', by criminal elements such as the bikie gangs, already well established in the industry in South Australia and Queensland, and the suggestion of gangs associated with lending for gambling in the clubs and casinos in Sydney. This was a topic that the regulators were warned of by the 2000-2001 Queensland Office of Fair Trading investigation into payday lending in South East Queensland, and in tabloid coverage in South Australia in recent years. What the consumer advocates and representatives from Legal Aid and Consumer Credit Law Centres will never understand, is that these people never appear before courts or tribunals because, unlike the legitimate industry participants being threatened with ejection from the industry, these people's mode of collection is based on physical intimidation and violence.

Non-commercial stakeholders support industry continuation

It is significant to note that there has been a clear message, from relevant non-commercial stakeholders, that they do not want the small amount, short term lending industry abolished.

1. The Minister has repeatedly stated that he wants a viable industry. Such statements being included in comments made at a major 2011 consumer advocate conference, in his relevant media releases and in both of the meetings he has held with sector representatives (considered in greater detail below).

2. Minister Shorten confirmed his view in the last paragraph of his Second Reading Speech introducing the current Bill into the House on 21 September this year, when he concluded, "*The bill I am introducing today demonstrates our commitment to stand alongside consumers, <u>but it also puts the importance of the access to credit and the growth and long-term sustainability of financial services businesses at the heart of our vision for the future</u>*".

3. In the Treasury Department's Discussion Papers over the last 12 months, and during meetings with commercial stakeholders, Treasury has repeatedly stated that the aim of the reforms is to further protect the *"desperate and vulnerable"* consumer, while leaving a viable commercial lending sector.

4. At the recent launch of the RMIT University report, "*Caught Short - Exploring the Role of Small Short term Loans in the Lives of Australians*" (August 2011), ACOSS and Financial Counsellor representatives told senior lending sector representatives that they wanted a viable lending sector to remain.

5. The Consumer Action Legal Centre website states that organisation wants the lending sector to earn a "*reasonable profit*", implying recognition of a continuation of the sector.

6. The Good Shepherd submission to Treasury in response to one of Treasury's most recent Discussion Papers, while concerned about *"reasonable administration costs"*, recognised the need for a commercial sector to remain and commented on the concern to avoid *"credit exclusion"*. This approach was also supported in the Good Shepherd's response to the 2010 Green Paper on credit reforms.

7. Over 750,000 borrowers in 2010, with lenders commonly experiencing annual growth rates in the 15% to 30% compound range and an average of 18% (Smiles Turner industry research 2006, 2007, 2010 and industry analysis 2011), clearly indicate that the consumer wants a commercial sector to remain in business.

Without appropriate amendments to the current Bill, all the above people and organisations will have their preference ignored.

As indicated elsewhere in this submission, the introduction of the current Bill into law, without amendment, will not facilitate a continuing and viable sector, because it will effectively abolish the small amount, short term sector.

From no later than 3 months after 1 January 2013 lenders, who are all incorporated, will be forced to close - or risk breaking the law - as the Corporations Act demands that no company trade while insolvent.

SECTION 10

Facing the Realities

This Section considers the decision making environment in which consumer advocates too frequently attempt to distort the realities.

Idealism Compromised in the Face of Reality

The Delegation requests that the Committee consider the realities that consumer advocates and certain journalists always fail to acknowledge.

Commonwealth policy makers and regulators have to 'bite the bullet', no matter what the consumer advocacy lobby, one particular journalist with the Brisbane Courier Mail and some of the radio 'shock jocks' demand.

- Small amount, short term credit will always be relatively expensive compared to large amount, long term credit, measured by interest rate, and fees and charges in the nature of interest rate comparisons. Substantially similar advertising, compliance and management costs are involved - no matter what size the loan. With a small loans, these costs are spread over a much shorter period and over much fewer dollars borrowed.
- Small amount, short term credit is generally unsecured and faces higher default rates and proportionate default costs than large, long term loans, secured on real estate.
- People have got to step outside the mindset that the relevant comparison base for assessing the cost of any loan is what the major banks charge for a home loan. To do otherwise is analogous to demanding comparison of the features of a $15,000 Hyundai mini car with a $900,000 Rolls Royce.
- It must be recognised that the cost of borrowing $100 for a matter of weeks is the small amount of $30 or so, in comparison to borrowing $500,000 over many years and repaying $1.5 million, despite the apparently smaller interest rates charged for the larger loan.

Lessons from history

The small amount, short term finance industry has had a history of government intervention worldwide. The history of facing up to reality is supported by:

1. the experience of Victoria when, in 1998, it abolished its discredited and unworkable 48% pawn broking lending cap. The cap had been introduced 9 years earlier and had generated incidences of police corruption. Abolition followed an outcry from church groups, honest police and community organisations such as the Good Shepherd Foundation;
2. Minister Nick Sherry's comments at the Financial Services Regulation Summit, in October 2008, when he observed that the USA states that abolished payday lending had faced criminal elements moving into the lending void;
3. the fact that, in 2005, after the best and most comprehensive review of lending ever carried out in Australia to date, the State of Victoria <u>did not</u> move to a comprehensive interest rate cap model;
4. recognition that the 48% cap was the creation of one UK politician in 1927, who was anti-Semitic and obsessed with the concept of 'usury'. The UK removed the 1927 interest rate cap legislation in 1974, after decades of regulatory failure. In 2006, when the imposition of a cap had once again been suggested, the UK Government carried out a substantial and well researched review, with extensive contact with consumers themselves, not just 'consumer advocates'. The results of this review and two other reviews held since, led to the Government's outright refusal to return to the 1927 approach;
5. recognition of the successful anti-avoidance that has emerged in the USA, with many States attempting and failing to impose interest rate caps on their citizens, who just look over the state borders for their loans, or go to the internet services;
6. recognition that a 2007 Federal Reserve Bank of New York Staff Study strongly dismissed the value of interest rate caps in controlling the small loan market;

7. recognition that the 48% cap concept has become nothing more than an ill-informed 'mantra', with its champions never undertaking intellectually rigorous, or process appropriate research into consumers and their lending motivations and behaviours, and never visiting any of the small amount, short term lenders' premises to see exactly how they work and talk directly to the borrowers on site.

Policis research - Europe, USA and Australia

In recent years, the UK based international research firm, Policis, has published a range of reports concerning the microlending industry in several countries. Various reports have been published in association with the UK based Personal Finance Research Centre and with the UK Department of Trade and Industry.

The report entitled, "*The effect of interest rate controls in other countries*", August 2004, found the following:

(a) "*Those who feel they are unable to get credit have few means of managing cash flow crises or of acquiring items that they need but are unable to afford*";

(b) "*...borrowers on tight budgets prefer credit options offering readily accessible cash and ideally not requiring surrender of title to assets*";

(c) "*Consumers in both the UK and US are actively choosing a new generation of sub prime models over mainstream credit and traditional products*";

(d) "*The markets studied with rate ceilings exhibit less diversity in the credit products available in the market and the range of credit models offered to low income households is sharply narrower*";

(e) "*Sub prime credit models... are either unable to develop, in the case of established ceilings, or forced out of the market, where ceilings are imposed*";

(f) "*Germany provides a good example of how a rate ceiling, particularly when combined with disincentives to default, can result in a highly risk averse lender set. Credit scoring thresholds and lending criteria in Germany have been set at a level which would tend to exclude high risk groups. Low-income borrowers are generally able to obtain credit only if in secure long term employment. Minimum loan values are set at a level significantly above that likely to be sought by those on the lowest incomes*";

(g) "*An extra dimension is added by the absolute exclusion of the credit impaired in France and Germany which has created the conditions for illegal lending*";

(h) "*The credit impaired in France and Germany appear more likely to use illegal lenders than in the UK where there are legal credit options for such borrowers*";

As was considered in the Policis paper entitled "*The impact of interest rate ceilings*":

"*Rate ceilings do not appear effective in preventing over-indebtedness and indeed appear to make it more likely and to exacerbate its effects:*

1. *The rate ceilings in France and Germany have not prevented significant and rising levels of problem debt, over-indebtedness and insolvency.*

2. *Over-indebtedness in the UK is low and the major indicators of problem debt have declined over a long period, with recent rises from a low base.*

3. *Outgoings on debt service are very similar in all three countries but in France and Germany:*

    - *Debt is significantly higher and over-indebtedness is significantly more likely.*

    - *More debt is open ended and long term, leaving individuals more exposed in the event of a down-turn in fortunes or the economic cycle.*

4. *Consequences of problem debt, both short and long term, are significantly more damaging in France and Germany than in UK:*

    - *Lenders are less tolerant of payment difficulties, in large part because of the lack of flexibility associated with price controlled products;*

    - *The consequences of delinquency are more serious and the sanctions for default more rapidly applied.*

- *As a result, in both France and Germany, those with credit difficulties are more likely to prioritise debt service over essentials to avoid sanctions.*
- *Those with payment difficulties are more likely to suffer fuel poverty and to undermine their financial security by not paying rents.*
- *Insolvency is more likely to follow payment problems.*"

In the same paper, Policis researchers Anna Ellison and Robert Forster, identified a number of negative impacts on credit supply created by interest rate ceilings in the various countries they researched. These included:

- "*Lenders cannot afford to cross subsidise high risk borrowers without risking their competitive position.....*
- *Where ceilings are effective in containing price, lenders withdraw from markets where they cannot lend profitably.*
- *Lenders in these markets also set minimum lending levels higher than is appropriate to the needs of low income households and high risk borrowers.*
- *The constrained credit product mix in price capped markets leads borrowers to use products which are less suited to their needs and expose them to greater risk.*
- *Where ceilings are imposed those without options are diverted to pawn - and illegals - while others are primarily diverted to mainstream revolving credit.*
- *Illegal lending tends to arise in a credit vacuum, is frequently associated with other criminal activity and is both very high cost and damaging to victims.*"

Other research also suggests a reality check

It is of concern to note that caps hurt people they are supposed to protect. Ann Duval, from the Consultative Group to Assist the Poor (CGAP), is a source of expertise in microlending associated with the World Bank. She has said:

"though meant to protect consumers, interest rate ceilings almost always hurt the poor …many countries have established interest rate ceilings to protect consumers from unscrupulous lenders. Governments often also face political or cultural pressure to keep interest rates low. Despite good intentions, interest rate ceilings generally hurt the poor by making it hard for new microfinance institutions to emerge and existing ones to stay in business. In countries with interest rate caps, MFI's often withdraw from the market, grow more slowly, become less transparent about total loan costs, and/or reduce their work in rural and other costly markets. By forcing pro-poor financial institutions out of business, interest rate caps often drive clients back to the expensive informal market where they have no or little protection."

Reference: "Donor Brief" No. 18, May 2004, www.cgap.org/direct.

Other reports against the introduction of a cap include the 2006 Department of Trade and Industry (UK) report which noted that a cap could make it hard for low income consumers to get credit and that people in countries where rates are capped are, in fact, more likely to have financial problems and borrow from illegal loan sharks. The Department's report noted that the number of consumers who admitted to having borrowed from unlicensed or illegal lenders was twice as high in Germany and France (where there are interest rate caps), than in the UK.

At the time, the Hon. Gerry Sutcliffe, Consumer Minister, said:

"Ceilings can often have a negative effect, such as excluding low income consumers from the market or leading them to use products that they know are not really suitable for their needs and which make it difficult for them to control their levels of borrowing" (BBC News).

The Federal Reserve Bank of New York's Staff Report N. 273, "*Defining and Detecting Predatory Lending*", January 2007, concluded:

"On the whole, our results seem consistent with the hypothesis that payday lending represents a legitimate increase in the supply of credit, not a contrived increase in credit demand…We find somewhat lower payday prices in cities with more payday stores per capita, consistent with the hypothesis that competition limits payday loan prices…The problem of high prices may reflect too few payday lenders, rather than too many".

In 2007 Canada abolished a national annual percentage rate as a cap. In most provinces, this was replaced with a maximum of up to $30 per hundred borrowed (in a country where the cost of living and housing is 30% less than Australia).

Also in 2007, the South Australian Parliamentary Economics and Finance Committee, in its Consumer Credit and Investment Schemes Report, recommended that the 48% inclusive cap not be introduced into that State until further research had been undertaken.

In August 2007, the New Zealand Ministry of Consumer Affairs released its "*Pacific Consumers' Behaviour and Experience in Credit Markets, with Particular Reference to the 'Fringe Lending' Market: Research Findings Report and Government's Response Strategy*". This report, adopted by the NZ Government, recommended against adopting a maximum interest rate cap.

In 2005-2007, the Asian Development Bank, based in the Philippines and the Consultative Group to Support the Poor (CGAP), based in Washington DC, both released reports warning against the adoption of interest rate caps.

On the 4th November 2007, Martin North, Managing Consulting Director of Fujitsu Consulting, which was engaged by the Australian Finance Conference (a coalition that includes the Australian Bankers' Association, Abacus - Australian Mutual, Mortgage and Finance Association of Australia, consumer groups, Legal Aid, law firms and the Public Interest Law Clearing House), was reported in the Queensland Sunday Mail to have said that care must be taken in any legislative remedy. *"Consumers must continue to take some accountability for their decisions, and not all require the same degree of protection"*. He further said, *"Experience from overseas suggests a light regulatory touch on the tiller works best"*.

Analysing the consumer advocates' statements

The consumer advocates tend to hold themselves out as representing all consumers when, in fact, their constituency appears to be fewer than 10,000 of the 750,000 borrowers of small amount, short term loans.

It is recognised that it is most unusual in a submission such as this to include critical comment about other stakeholders who might take a position in regard to impending legislation that is different to your own. However, the Delegation continues to be most troubled in regard to the inadequate and largely dated consumer research continually referred to by the consumer advocates, in an attempt to legitimise their position, and by statements made by various consumer advocate representatives that lack evidentiary support, or may be considered exaggeration.

As indicated elsewhere in this Submission, the Delegation is particularly critical of the consumer advocates' failure to undertake any research to explore the impact of the National Consumer Credit Protection Act, since its commencement on 1 July 2010, with the exception of a flawed 5 question survey conducted by Financial Counselling Australia. This is particularly so, since there has been no comprehensive academic study completed to date. The delegation is also critical of their continuing use of allegations that arise from activities before that date, while attempting to present them as relevant and "typical" of current circumstances.

In addition, it is noted that it is a consumer advocate strategy to exploit the "anecdote phenomena", whereby people will give more attention to a story involving an individual, regardless of the depth of truth involved, as opposed to statistics that clearly demonstrate that the purported victim in the story is an exception or one of a relative few and does not represent the majority in the relevant class of consumers.

In it's publication, "*Mission incomplete - A snapshot of consumer experience of short-term loans post the national consumer credit reforms*", Consumer Action Legal Centre (CALC), Victoria, May 2011, the Centre stated,

"It should be made clear that an interest rate cap will not solve the problem of financial hardship, nor is it intended to. A cap will merely act to prevent a particularly poor - and illusory - solution to that problem. A more genuine solution to the problem of financial hardship is likely to depend on a range of measures from better income support for vulnerable consumers to the provision of assistance in reducing debt, to the means to build assets - amongst many, many others".

The Delegation argues that a rate cap is not the solution to financial hardship. However, the Delegation argues that any attempt to abolish small amount, short term loans is socially and economically grossly irresponsible at this time.

In this Submission, the delegation does take issue with CALC for:

- totally ignoring the lenders' many warnings of what will occur if the current Bill is passed unamended;
- failing to do contemporary research, to enable a realistic understanding of the socio-economic dynamic involved; and
- their championing of a rate cap, while failing to make sure that there are adequate alternatives in place at the time of industry sector abolition.

CALC's energy and resources would be far better employed campaigning for their "*more genuine solution*" to the problem of financial hardship. Such being far more socially and economically responsible than seeking to fulfil their dream of a 48% cap and damn the consequences.

Reducing the number of loans to reduce the harm

The consumer advocates' simple solution is 'reduce the number of loans and you reduce the harm', "*In our view, reducing the availability of high cost short term loans will not harm consumers but in fact protect them*" (Ms Catriona Lowe, CALC, Joint Committee hearing, 24.10.11).

This solution is often presented in conjunction with a one-off story about a consumer with multiple loans who got into financial trouble, or a debt spiral. There is never any consideration of the majority of loans that are paid off without trouble and the proportion of borrowers who do not get caught in a debt trap.

In addition, there is never any consideration of the consumers having a personal responsibility in regard to their borrowing actions, nor to the repeated phenomena of consumers using consumer advocate organisations, in their attempt to avoid paying for a loan they are legally contracted to pay.

In this context, it is useful to note that, in accordance with Smiles Turner 2010 research, 92.7% of lenders had at least 90% of their consumers complete their loan term without incident. Cash Converters reports a bad debt ratio of 3% and Smiles Turner research has consistently found that 3-4.3% bad debts has been fairly standard, over several years, throughout the small amount, short term loan industry.

On the assumption that reducing/abolishing loans will reduce the number of borrowers in a debt trap, as discussed elsewhere in this Submission - it does not make sense to abolish 100% of the loans, just to stop circumstances that currently effect less than 3% of the borrowers.

The Delegation believes that it is appropriate for the more than 97% of borrowers to be recognised in the formulation of legislation that will impact significantly on their ability to obtain a loan of their choice.

Analysis of research reports and public statements

In order to assist the committee to take a balanced view when reviewing the claims of the competing stakeholders, the Delegation provides an analysis of:

- the 2nd September 2011 CALC publication, "*Broad support for proposed payday lending reforms*".
- the May 2011 CALC publication, "*Mission Incomplete - a snapshot of consumer experiences of short-term loans post the national consumer credit reforms*";
- the September 2010 CALC report "*Payday loans: Helping hand or quicksand?*", which also makes some comment with regard to earlier research undertaken by Dean Wilson, on CALC's behalf;
- the 2002 Dean Wilson, CALC, publication, "*Payday Lending in Victoria*", 2002;
- CALC's current website, "www.debttrap.org.au"; and

- the RMIT University Report, "*Caught $hort*", published in August 2011 and frequently referred to by the consumer advocates.

We conclude this chapter with a consideration of a number of public statements made by consumer advocate representatives that deserve very critical assessment.

CALC's "Mission Incomplete"

This document, outlining 12 individual borrower "*case studies*", constituted CALC's alternative to proper research post-1 July 2010 and in 2011. To obtain these "*case studies*", with no attempt to verify them, CALC relied on a circular to consumer advocate, legal and welfare organisations around Australia, asking for their anecdotes. There was no indication that more than 12 case studies had been collected, despite this national multi-agency appeal.

The Delegation's concerns include:

- There is no attempt to verify, in any way, that the 12 "case studies" were people who had been interviewed post-1July, or who had actually taken out their loans post-1 July.
- It takes until page 6 of the current document for the presentation of a highly relevant admission, which totally destroys any credibility associated with the document being used to justify future regulation initiatives. In CALC's own words:

  "*The cases cited herein do not claim to be representative or of a statistically significant number*".
- CALC's conclusion is not substantially supported by the "*case studies*".
- The document concludes, "*Responsible lending provisions have failed to address the detriment caused to the consumers in these case studies... (they) have failed to stop these consumers becoming over-committed by <u>ongoing easy access</u> to this expensive line of credit.... <u>only</u> a national comprehensive interest rate cap of 48% can <u>effectively</u> minimise the harm caused...*".

  However, when assessing CALC's own case study descriptions, easy access was a relevant factor only in four, or possibly five, of the case studies; the high cost of interest rates, fees and charges was a possible determining factor in <u>only two</u> of the case studies and, as previously mentioned, there is no verification that the case studies were covered by the "*responsible lending provisions*" at all.

Examining the case studies

- <u>None</u> of the 'easy access' case studies were also 'high cost' factor case studies and five of the case studies did not fall into either easy access, or high cost categories.
- In only two out of the twelve case studies, would capping the total cost of credit to 48% have possibly assisted in a pivotal manner and erased the consumer problems identified.
- Applying a 48% cap would have made no difference to the negative circumstances associated with the four or five case studies (the description given makes one uncertain) involving too easy access to credit, or to the remaining 5 or 6 case studies where neither easy access, nor cost, were the central issues

In the content of the document, CALC <u>fails to prove</u> the need for a 48% cap.

In addition:

1. There is no attempt to explain what the consumers will do without the opportunity to borrow.
2. There is no recognition that the championing of the 48% all inclusive cap means effective abolition of commercial short term loans.
3. Only consumers in financial difficulty and in contact with CALC and financial counsellors were included as case studies, introducing a <u>significant bias</u> in their selection. There was no attempt to explore case studies from consumers who did not approach CALC or financial counsellors, as a control group.
4. Eight case studies involved consumers with family and lifestyle choice issues as the basic, or major, cause of their problems or motive leading to unwise borrowing.

5. One case study did not provide any evidence of CALC's claim at all.

The "*Mission Incomplete*" document purports to represent an assessment as to "*whether the issues we had long identified had changed in light of regulatory reform which took effect from 1 July 2010*".

What follows are 12 anecdotes without any comparative statistical analysis, and a statement claiming relationship with similar case studies in the 2010 report. However, there are no such case studies in that 2010 report - yet the 2011 document includes a conclusion that "*the problems remain*".

The "*Mission Incomplete*" document also states that CALC has undertaken an "*examination of the experiences of people who have recently used high-cost, short term loans*". This "*examination*" constituted no more than a very wide appeal for anti-microlending stories that went to similar Centres and financial counsellors, and reproduction of those stories - with admitted slight editing.

There was no evidence as to any investigation having been undertaken to determine the stories' veracity, or detail the end result, and the authors of this document did not have any contact with the consumers themselves. None of the lenders named were provided with an opportunity to comment and we have only the financial counsellor or lawyer's account to consider.

The attempt at painting the whole microlending sector as bad is further called into question when you consider the small number of lenders identified. Further, the lack of independent analysis, beyond the memory of the lawyer or financial counsellor who provided the anecdote, is of concern.

Only three of the companies were identified and alleged to have adopted lending policies that, in themselves, attracted criticism. One of those companies has established that the information given by the "client" was false and another has established that they were not the relevant lender involved with the case cited. Neither case study has been amended or removed from the document.

The publication included statements such as:

"*Excessive high loan costs are being charged in States and Territories where there is no comprehensive interest rate cap*".

Delegation comment: There is no comparative statistical or qualitative evidence provided to support this suggestion. One NSW consumer case study is included, but not as a contrast to the other case studies. There is no case study from the ACT.

"*The total amounts to be repaid, and short-term repayment schedules themselves, are still causing hardship as consumers struggle to repay loans*".

Delegation comment: Only 4 of the 12 case studies involved this type of hardship.

"*Loans are still being provided to fund recurrent, day to day living expenses*".

Delegation comment: This appears to be an issue in 5 of the 12 cases studies. The document does not provide a solution to this issue.

"*Repeat borrowing (rollovers) continues to provide problems*".

Delegation comment: Only one case study out of the 12 involves this issue. Smiles Turner research statistics indicate that there has been in excess of 300,000 "repeat borrowings" (rollovers) since 1 July 2010 and COSL has not chosen to segregate rollovers as a separate complaint category since the introduction of the 1 July reforms.

The 12 cases studies were "*sourced from our own client base, and from the broader financial counselling sector*".

Delegation comment: These sources represent only the minority of consumers in trouble. There was no attempt to source a sample from the total population - not even to compare as a control group.

It is alleged that the 12 case studies "*...suggest that responsible lending laws have not been effective in curbing high-cost short-term lending that contributes to and exacerbates consumer hardship*".

Delegation comment: There is no acknowledgement that:

- in 11 of the case studies, the consumers involved actually contributed to their problems themselves;
- none of the case studies included reference to a lender being forced to borrow;
- all case studies involved adults - most of whom have married or entered into partnerships, all of whom have the right to vote, most of whom have held down full time jobs and only one of whom is alleged to have had comprehension difficulties; and
- In 7 of the case studies, details were provided indicating non-microlending issues as the basic cause of the consumer's problems.

In regard to complaints, the Delegation is concerned to comment on the following statement:

"*It is also likely that few high-cost short-term loan consumers will lodge complaints, with the sum of one loan unlikely to justify the time and effort required by the consumer to pursue a complaint. This rational inertia may be exacerbated by a disadvantaged background and the need to deal with other financial and life pressures and difficulties*".

Delegation comment: Again, there is no research provided to support these assertions. A guess ("*It is also likely*" and "*may be*") is not enough on which to base new regulation.

It should also be noted that it has never been easier to lodge a complaint. At least 3 times in their contract documentation, consumers are informed as to where to contact COSL or FOS and that they have a free complaints' mechanism to exploit.

When they default, they get at least two more reminders as to how and where to complain, and at no charge. The authors are unaware of any other industry where there is such a demand to emphasise where a consumer may go to complain.

The CALC document, dated May, includes case studies claimed to be associated with the period August 2010 to April 2011 inclusive. From July 2010 to April 2011 inclusive, the Credit Ombudsman Service Limited (COSL), the external dispute resolution service that involves most microlenders, reported 70 complaints, only 32 of which would cover similar issues as the case studies. While the 32 complaints are not isolated from the total, it may be useful to note that only 33% of all complaints were decided in favour of the complaining consumer.

We stress again - putting the COSL complaint numbers into perspective - there were 1.5 million microloans advanced in 2010. Further, research by Smiles Turner, in April and May 2011, reported increased loan numbers for the first 5 months of 2011.

In conclusion, there were only 12 case studies collected by CALC after an Australia-wide appeal to financial counsellors and consideration of CALC client files in every state. At the time the document was written, there was also the availability of only 32 COSL complaints that appeared to raise issues such as those claimed in the case studies. This despite the extremely large volume of loans advanced during the relevant time period.

With its lack of credible statistics and lack of evidence to support its claims, CALC absolutely failed to prove that the responsible lending provisions, introduced in July 2010, have universally failed.

2010 CALC Report

This very flawed publication, ("*Payday loans: Helping hand or quicksand?*", September 2010) was based, in part, on very poor and uncoordinated research efforts that were two and three years old, including one (only) quantitative study.

As mentioned earlier, this report was written long before the post-July 1, 2010 period of Commonwealth regulation associated with major consumer protection reforms.

"Mission Incomplete" included the statement that the 2010 report "*concluded that the most effective consumer protection tool was a comprehensive interest rate cap of 48%, inclusive of all fees and charges*".

This was spectacularly incorrect. On a number of occasions throughout the 2010 report it included the statement "*Rate caps are the only proven payday lending reform*", or similar.

However there was <u>no</u> empirical evidence provided to support this view, nor was there any attempt at a comparative analysis of the various Australian jurisdictions that had, or did not have, caps at the time the report was written.

The references to this 2010 publication in "*Mission Incomplete*" was unfortunate for another reason - the 2010 CALC report was <u>fundamentally flawed</u>.

It purported to consider four issues, including the one relevant to the 2011 document, which was - to what extent do microloans (referred to as payday loans in both documents, but including all microlending) resolve and/or exacerbate financial problems for consumers?

Relevant to this question were the following flaws in the 2010 report:

1. An assertion that (all) consumers were not in a position to freely choose microloans (a last resort), was contradicted by their own "research data", reporting that none of the participants indicated they did not have access to another source of finance. 41.5% even indicated that they had more than one other source (pages 77, 78).
2. Supporting the claim for a 48% cap - payday loans prevented consumers "*...from becoming stable, economically productive participants in the mainstream economy*". However, only 8% of their research respondents were unemployed (pages 218 and spreadsheet file Att B - pay day lending survey data).
3. After asserting that a cycle of repeat borrowing (leading to a debt spiral) was the result of the availability of payday loans, their research indicated that 74% of respondents had only 1 or 2 loans over the previous 18 months (pages 69 and 217).
4. The report asserted that payday lending was usually undertaken to assist paying for basic living expenses. This was contradicted by their research, which reported a 33% decline for such borrowing since 2002 and the substantial borrowing associated with motor vehicles (page 59).
5. The report was presented as being about payday loans but, on the author's admission, mixed information concerning other loans into the analysis (page 36).
6. Sub-conclusions presented to 'support' the fundamental conclusion that a 48% cap is required, were contradicted by their research.

   For example, "*...the core consumer base ...is made up of young consumers on low or very low incomes*". However, the included research results show that the income levels for 49.3% of these respondents was between $21,000 and $60,000; that 20% of participants were 18-24 years and that the "core group" was in fact the 25 to 44 year olds, who constituted 60% of the consumers (pages 47, 53, 216).
7. The contracted research company used paid respondents and <u>excluded</u> any from NSW or the ACT - the critical cap regime jurisdictions (see Excel spreadsheet Att B - payday lending survey data).
8. Qualitative research was limited to residents from Geelong and Fitzroy in Victoria, for what was admitted to be "*a very small scale study*" (pages 230, 236).
9. Examples of the personal and financial circumstances of people were presented as detailed findings, supporting payday lending criticism. However, poor money management skills were the most frequent problem, illustrated by pre-existing and continuing utility and phone service debt, credit cards over extended and large loans. As with the majority of the twelve 2011 case studies in "*Mission Impossible*", in almost all 2010 examples payday lending was neither the cause of the problem, nor even a significant consequence of the problem (pages 240 to 254).
10. The report acknowledged that it was credit cards and larger loans that were the major problem, <u>not</u> microloans - "*On balance it seems that it is the larger loans and credit cards that get them into trouble rather than the small amount, "payday" loans*" (page 251).

2002 Dean Wilson publication

CALC's selective choice of Mr Wilson's findings are presented to imply that the material selected supports their concerns.

However, to state that Mr Wilson found a certain proportion of borrowers to be Centrelink recipients so, on that criteria alone, to deem them as "harmed" by the payday loan advanced, is to attempt a quantum leap without any data in the Dean Wilson publication to support such.

Any consideration of Mr Wilson's publication must bear in mind that the research was carried out in 2002, before substantial State, let alone Commonwealth, consumer protection legislation and regulations were introduced and the fact that the total number of respondents was limited to 78, but only 72 were actually borrowers and were approached on the street outside a small selection of lenders in Victoria. Unfortunately, when approached, the interviewing time was stated as 3-5 minutes.

The Delegation is uncomfortable that such a short period of time would allow the respondent the opportunity to provide considered responses. Mr Wilson also interviewed 11 people and the Delegation is somewhat concerned that the report merges quantitative and qualitative findings, a deficiency also observed in the 2010 CALC report.

CALC's "debttrap.org.au" website

The current "debttrap.org.au" website shows the same un-researched lack of reality that permeates the Consumer Credit Legal Centres' publications, and links to the same flawed publications.

In particular, the following messages must be challenged:

1. Pay Day lending causes poverty with no money, after repayments, to buy food.

Delegation comment: Such a statement has now to be considered in the light of the post-1 July 2010 major reforms introduced by the commencement of the National Consumer Credit Protection Act 2009 and the associated regulations 2010 and 2011. Lending in such a circumstance would clearly constitute offering a "not suitable" loan which, as previously mentioned, attracts penalties of $220,000 for an individual and $1.1 million for a company.

Further, since 1 July 2010, there has been no record of any lender being the subject of a relevant complaint to ASIC by CALC, or any other community organisation, in regard to a borrower being left without money for food due entirely, if at all, to the loan repayments faced. It should be noted that these types of complaints can be made under Sections 243 and 247 and following of the NCCP Act, where the complainant is protected by qualified privilege in the provision of information to ASIC regarding a breach. ASIC has very wide and general powers to investigate such matters.

2. With the introduction of the Bill, illegal lending will not occur.

Delegation comment: This is not supported by any academic studies, including those by international research firm Policis, studies in Europe and the USA, nor by academic studies in the USA, including the Reserve Bank of New York and studies in jurisdictions where payday lending has been banned or severely curtailed.

Following a substantial review of all the literature available, the Law and Justice Research Centre, Queensland University of Technology, March 2011 report, "*Phase two of the National Credit Reforms Examining the regulation of Payday lenders*", concluded, on page 55, "*…an all inclusive cap is likely to have the effect of prohibiting payday lending as being unprofitable …If the cap works properly so that avoidance is not possible, lenders may respond by leaving the market… Withdrawal …is likely to produce financial exclusion or channel the most vulnerable borrowers to illegal lenders*".

It should be noted that an Australian Inquiry - the Queensland Department of Fair Trading's "*Pay Day Lending - A Report to the Minister of Fair Trading*", actually raised the issue of illegal lending post-a 48% inclusive cap being introduced in 2000. Further, there has already been significant documented evidence of interest in participation in the small amount, short term loan sector by bikie gangs in South Australia and Queensland.

The Delegation notes the inclusion in CALC's very own 2010 Report, acknowledging that unlicensed illegal lenders operate in Europe. Further, that the level of illegality is higher in countries with an interest rate cap than those without.

At pages 187-189 in the CALC report, it mentions the research undertaken for the UK Department of Trade and Industry in 2006, which compared the UK to countries with an interest rate cap such as France and Germany and concluded that illegal lending was higher in those countries, with Germany's statistics being 200% to 300% higher than in the UK, which does not have an interest rate cap.

3. The new laws are not designed to close the lenders down.

Delegation comment: CALC and other community organisations' representatives have repeatedly had it explained to them, particularly during the Treasury's Industry and Consumer Consultation Group meetings, as to why the sector will be forced to close down if the current Bill is implemented without change, whether or not this was the intended outcome.

4. The imposition of a national 48% cap follows success with such a cap in NSW, Queensland and the ACT.

Delegation comment: This completely ignores the reality, which was clearly acknowledged in the Regulation Impact Statement. There has been no "*success*" associated with the caps in these jurisdictions. There are no lenders lending under these State's cap regimes. Credit providers have avoided the cap with a range of avoidance measures - all supported by extensive legal expertise - because they have had no choice but to do so, if they were to avoid insolvency and bankruptcy.

5. The continuation of the NSW cap this year demonstrates the legitimacy of the approach.

Delegation comment: This significantly overlooks the fact that a CALC representative participated in an ABC radio segment with the NSW Minister, a few days after the legislation was passed by the NSW Parliament, during which the Minister demonstrated his total misunderstanding of the impact of the 48% cap. When asked what income lenders received under his legislation, for lending $100 for 1 week, the Minister replied $7 to $8 (which in itself would not even cover staff costs). The correct answer is actually a maximum of 92 cents.

In fairness to the Minister, the Delegation recognises that he was very new to the job and he was on a fast learning curve, in the face of substantial information being provided to him by both the consumer advocates and representatives from the lenders, all within a matter of days. It is understandable that he would see the continuation as expedient, particularly given the Commonwealth takeover scheduled for just 12 months later.

6. Presentation of the single bankrupt case study to support the Bill.

Delegation comment: This is a continuing ploy used by CALC, where one example is projected to be symptomatic of the whole sector. The facts are that 94.6% of all borrowers repay their loans - over 75% of these without any defaults. None of the small amount, short term lenders have been known to instigate a bankruptcy petition against a consumer (Smiles Turner industry research 2001, 2003, 2005, 2006, 2007, 2010, 2011).

7. Credit providers publishing APRs "allows comparisons".

Delegation comment: If CALC had undertaken appropriately professional consumer research at any time since mandatory APR publication was introduced, it would have discovered that consumers are not interested in APRs and rarely refer to them when making their lending decisions (Smiles Turner consumer research 2006, 2007, 2010).

8. Dismissal of the Commonwealth's responsible lending regime rules.

Delegation comment: The final criticism we list in regard to the "debttrap.org.au" website is the statement, "*We believe that they will have little impact*" in regard to the mandatory responsible lending and other reform regulation. CALC has now had 14 months to research the impact of the Commonwealth takeover and the results of the responsible lending regulation already implemented. Had CALC availed itself of that opportunity, it would have observed the industry's enthusiastic embracing, at considerable cost, of the responsible lending model. The Delegation is confident that the ASIC report on the payday and microlending sector will support that comment.

To dismiss the impact of a core provision of a major legislative program with "*we believe*", while championing further draconian legislative provisions, is simply blatantly irresponsible behaviour from taxpayer funded organisations, employing tertiary trained professionals.

CALC - September 2011 newsletter-style publication linked to the website

This document, with its heading "*Broad support for proposed payday lending reforms*", with a link to a copy on the CALC website, presented 11 organisations as supporting CALC's campaign in favour of a 48% cap and other reforms.

Each organisation demonstrated their ideological commitment but, yet again, there was no factual support presented as to the 48% cap's economic viability, or as to the capacity of non-commercial alternatives to provide sufficient cheaper, no-cost loans to all consumers.

A typical comment included was attributed to Kildonan Uniting Care. That organisation commented, without detail, "*There are often other options that are more affordable*".

Caught $hort - RMIT University

In respect to this study, the Delegation notes that the sampling methodology was somewhat unfortunate and must be considered as methodologically unsound. Frequently referred to by consumer advocates, to justify their position, the Delegation suggests that any consideration of this report must bear in mind:

1. There were 4,000 invitation cards distributed, but only 112 consumers responded and were interviewed (a 2.8% response). The propensity for skewing the research results is substantial. In comparison, Smiles Turner research is conducted on the basis that between 85% and 95% of potential borrowers approached respond to the self-administered questionnaires for the surveys mentioned in this Submission, or personal questioning for industry analysis;
2. all 112 participants were paid;
3. the research is skewed to the unemployed (only 24% with some form of employment), Centrelink benefit recipients (78%) and a particular lenders' customers, because interviews were conducted during the business day and, at least in one area, selection was based on talking to as many consumers as the lender could send down to the researcher sitting in the local coffee shop. The Delegation has some discomfort in regard to respondent number bias, privacy and objective response issues concerning this data collection approach;
4. the employment of "*semi structured questions*" introduces major opportunities for interviewer introduced bias;
5. this problem is enhanced with the attempt to recruit respondents via cards distributed, not only to lenders, but to "*financial counselling agencies, Neighbourhood Houses and other community organisations*". These agencies and organisations only deal with people in difficulty, and including a group of consumers sourced in this manner (46% of total borrowers interviewed) <u>does not</u> give you an industry-wide representative sample. Any extrapolation ignores the fact that the industry average where loans proceed as originally contracted, is in excess of 90%, that 97% of all loans are fully repaid and fewer than 400 out of the 750,000 borrowers attempted honest challenges in 2010 (not always with legal justification), with the help of the consumer advocates, free legal services and the external dispute resolution services (Smiles Turner research 2010 and industry analysis, 2011).
6. The research associated with 84 (75%) of the respondents, at least in considerable part, relates to pre-1 July 2010 circumstances, given the interviews were conducted "*between July and November 2010*" and much of the respondents' comments would have had to relate to the pre-NCCP Act period. It does not appear that the respondents were asked to clarify their views according to whether or not they were formed before, or after, 1 July 2010.
7. 28 (25%) of the face to face interviews were conducted by the University of Queensland team during 2009. On that alone, 25% of the interviews relate to a different sample set, from a different population. This is most unfortunate because it excludes the impact of the post-July 1 responsible lending regime completely, yet their answers are mixed with post-July 1 interviews.
8. Aside from there being very low numbers on which to base national projections, the problem with this response is its geographic footprint.
   - NSW, one of the two largest markets (by jurisdiction) for small amount, short term loans, was represented by just 8 "*regional*" respondents - 7.1% of total.
   - 60 of the respondents came from Victoria - 53.6%.
   - Brisbane and Melbourne "*metro*" provided a total of 72 of the respondents - 64.3%.

As a result -

(a) The figure of 78% of respondents being Centrelink benefit recipients is far higher than any other published research result, or those of Smiles Turner.

(b) 75% of respondents borrowed a maximum of $500, which somewhat limits the findings to payday loans, not the spread of small, short term loans that includes microloans and which the current Bill also seeks to regulate.

(c) Only 7% having a credit card is a far lower proportion than the other abovementioned research.

(d) 8 respondents were homeless. None of the lenders knowingly lend to these people. If they were granted a loan, there is a considerable chance they were lying on the applications.

(e) 23% were involved in "*spiralling*", which the industry calls "rollovers". In April 2011, Smiles Turner Lender research results indicated that, for all companies involved, the average was 2.4% of total consumers. For those companies that allowed rollovers, the average number of consumers who took advantage of that policy was 4.94%, with 13 of those companies reporting 5% or less of their consumers borrowing in such a manner. It may be useful to note that 31% of the companies polled did not offer rollovers.

(f) It is disturbing that a comparison was attempted between the high rates of the different Centrelink benefits represented in the survey sample, as opposed to the Australian population, "*overall Centrelink population*" or the "*overall …payment population*". This implying that the higher proportions were connected to lending, as opposed to the methods by which the sample was selected.

The delegation would have hoped that this major investment in research could have produced a more sound methodology and process acceptable outcome.

It is noted that the study was "*Funded by a three year Australian Research Council linkage grant in 2009 with financial support from Good Shepherd Youth & Family Service and the National Australia Bank*" and that "*The chief investigators and research partners will present a final report in late 2011*". It is unfortunate that a research project, specifically intended to assist in the formulation of sound policy to guide the implementation of the Commonwealth's consumer credit protection regime, has taken three years to interview 112 consumers in a market of 750,000, and that the final report, at time of writing this submission, is not known to be scheduled for release prior to the Committee concluding its inquiry and, possibly, the Parliament voting on the Bill.

The Delegation does not believe the Committee should accept the research results as a useful source of information that accurately represents small amount, short term borrowers as a whole, nor accept consumer advocates' assertions, based on these results, as having any validity.

What the consumer advocates <u>do not</u> refer to

Notwithstanding the Delegation's concerns listed above, there are a number of conclusions and comments in the RMIT University report that are very conveniently overlooked by the consumer advocates, because they do not support a 48% inclusive cap as the answer. These include:

1. The Executive Summary conclusion, which stated "*Ninety nine respondents had often strongly-held opinions about what needs to happen to help people on low incomes. The most common views were:*
   - *Increase Centrelink payments and pensions (43 per cent of respondents).*
   - *Increased government support for education, training or finding a job (27 per cent).*
   - *Centrelink payments be made weekly rather than fortnightly.*
   - *Centrelink advances be more flexible to reflect respondents' borrowing practices with small loan, short term lenders (23 per cent). Many proposed that smaller amounts (down to $50) be available through Centrelink with short repayment schedules of two to four fortnights*".

2. Under the section entitled "*Borrowers ideas and hopes for the future*", this list was extended with the addition of the following:
   - "*More jobs or more steady jobs (13 per cent).*
   - *Eight per cent of respondents, nearly all women, talked about the need for greater recognition and respect for the circumstances they faced.*
   - *Seven per cent commented that the minimum wage was too low*".
3. 83% of all respondents did not want the lenders abolished.
4. 93% of those who borrowed under $301 supported the continuation of lenders and 62% of those who borrowed more than $301.

   The Minister and consumer advocates will be concerned to learn that 10% said that there was enough being done, or that no more could be done.
5. Under the sub heading "*Discussion*":

   "*A 48 per cent cap, of course, would be unprofitable for a sector which deals with high risk lending practices ...therefore what is at stake in this debate is the existence of payday loans below $500. Those campaigning for a 48 percent comprehensive cap consider they are supporting borrowers by taking away their access to lenders. Most borrowers interviewed for this research, particularly those with the least financial means - do not agree with such a unilateral approach. Instead many interviewees have proposed alternatives to help them meet their regular and irregular expenses and needs prior to any movement in this direction*".

   "*Borrowers requiring a loan to meet household expenses would benefit if the No Interest Loan Schemes were to be expanded... However, micro finance should not be seen as a replacement to payday lending. Interviewees were twice as likely to take out a loan to help meet their day-to-day, rather than irregular expenses*".
6. Under the Interim report's subheading "*Findings*" - "*The current debate about the impact of payday lending on the lives of many borrowers needs to be reframed from a market to a welfare issue*".

Recent consumer advocate comments - print media

"*The key issue here is whether you've got a product that's appropriate for the people it's being provided to*" - Ms Carolyn Bond, Chief Executive, Consumer Action Law Centre, The Australian Financial Review, 26 August 2010.

Delegation comment: A compound increase in demand of 18% across the board and 750,000 borrowers in 2010, would indicate that many people would regard the product as "*appropriate*" and many of those people would feel affronted that their ability to choose a loan that was "appropriate" was being questioned.

"*The chief executive of the Consumer Action Law Centre, Carolyn Bond, said the biggest concern for consumers regarding payday loans was that borrowing money on a short-term basis with high interest rates created a cycle of debt they were unlikely to be able to escape*" (Sydney Morning Herald, 28 August 2011).

Delegation comment: The attempt to apply this assessment to all borrowing is contradicted by Smiles Turner research figures, which reveal bad debt rates of 3% (2006, 2007, 2010, 2011 research).

Even with the biased sample collection associated with the "*Caught $hort*" RMIT Interim Report, which one would expect should more strongly support the allegation, the report indicated only 23% had rolled over a loan in the past and 44% had, in the past, immediately taken out another loan after finishing paying off the previous loan. Both figures are a long way from the 100% implied.

Significantly, the RMIT Interim Report included a table which listed 10 types of debt under two subheadings - "*outstanding debt*" and "*past debt*" and listed Centrelink debt or advance as "*types of debt mentioned by respondents*". Neither payday nor microloans rated a mention.

In the same article, Ms Bond was quoted as saying, "*Given that many of these consumers are living from day to day with their expenses, it is likely that they are already in financial difficulty* *and there is a great risk that their financial problems will only get worse as the interest charges are very hard to keep on top of*".

Delegation comment: For a $500 loan for one month, at the 600% the Minister quoted in the same article, the dollar amount of interest is $122.64. This constitutes a retail mark up of 24.53%. Assuming weekly repayments, the consumer would repay three lots of $155.69 and one payment of $155.67. As the Delegation considers in detail elsewhere in this Submission, it is the repayment of the loan principal, not the interest, that provides the real repayment challenge.

Consumer Action's Catriona Lowe said, "*Repayments are generally secured through direct debits, which take a first stake in a borrower's income leaving a low-income borrower without enough money for everyday living*" (Courier Mail, 4 September 2011).

Delegation comment: As discussed elsewhere in this submission, direct debits do not necessarily secure "*first stake*" and, if a lender leaves any borrower in the circumstances claimed, it is a major offence under the responsible lending provisions of the NCCP Act. Very significantly, there has been no Consumer Action Legal Centre complaint lodge with ASIC to date, alleging such a circumstance.

Ms Lowe's further comment on 4 September, "*We'll be marking the success of these new laws against two very simple measures: have they led to a reduction in harm cause by high cost, short term loans, including a reduction in fees and effective interest charged, and has the overall number of these loans significantly decreased?*".

Delegation comment: Ms Lowe does not indicate any appreciation as to what is about to happen if the measures she champions become law, and there has been no successful attempt to convince her organisation to do the essential contemporary and honest research required to inform her. However, Ms Lowe will be able to claim success according to both criteria, if the current Bill is introduced unamended. There will be a reduction in the currently perceived harm, because there will be virtually no loans available under the regime she favours, but the current "*harm*" will be replaced by a range of very different harms affecting most intending borrowers, not just the tiny minority (while still important, considerably less than 2% of total consumer numbers) Ms Lowe and her colleagues see now.

Ms Uhr (Queensland Legal Aid) said that, in Queensland, many loans were secured over cars and property. "*We see loans escalate. And the reason they have come to get legal advice is because they're losing their car or losing their home*" (Courier Mail, 25 October 2011) and also included this in her evidence before the Joint Committee.

Delegation comment: As considered elsewhere in this Submission, almost none of the payday or microlenders take security on a home. During 11 years of research, Smiles Turner has <u>never</u> come across a consumer losing their house as a result of any payday or micro-loan. We regard the claim of people losing houses over unpaid payday and microloans, implying that such happens generally, as an extremely unfortunate misrepresentation of the reality that may relate to dubious cases, with neither being payday loans.

CALC submission to the Joint and Senate Committees

The Delegation is pleased to note that there is little, if anything, in this submission that is in conflict with the Delegation's recommended option.

However, there are a number of inclusions that cannot be left unchallenged.

A number of extracts from the submission are listed below, followed by the Delegation's response:

"*…to our knowledge, the cap model the Government has chosen (a 10 per cent establishment fee plus a 2 per cent monthly fee) is untested …we believe that the proven solution of a comprehensive interest rate cap of 48% is the best way to cap costs of high cost short term credit. However, we support the government's proposal as the "next best" option*".

Delegation response: Treasury has confirmed, before both the Senate Estimates Committee and the Joint Committee on Corporations and Financial Services, that the 10%, 2% model is untested (no economic modelling having been carried out and no other jurisdiction having adopted it).

However, the same comment applies to the 48% cap. It is <u>not</u> proven and the CALC submission explains why, several pages later, when it considers the avoidance in Queensland, NSW and the ACT since a 48% cap was introduced in those jurisdictions. Such explanation is also offered in the RIS written 14 months earlier.

The delegation asks the Committee - how can any assessment be made as to what the "next best" option may be that will effect 750,000 people, when you are attempting to compare two models, neither of which have been tested?

"*...evidence indicates that repeat borrowing is the norm. For example, the recent Caught $hort study from RMIT University found that over half of the respondents to their study had taken out more than ten loans, with many saying they had received over 50 loans*".

Delegation response: The respondents were asked how many loans they had taken out "*ever*". As mentioned elsewhere in this submission, there was no information on the periods of time involved over which these loans had been taken out, and a conclusion that a series of successive loans had been take out, with little or no time between them, cannot be drawn from this study.

"*They (the high cost short term loans) are predominantly issued to people on low fixed incomes ...the people these loans are targeted at are the very people who can least afford them*".

Delegation response: As discussed in detail elsewhere in this submission, the studies quoted on page 4 of the CALC submission are all biased towards the low income borrower and they are the same studies referred to in the RIS. As quoted, the RIS concludes that "*possibly up to 25%, have incomes that are so low that they fall beneath the Henderson Poverty Line*". Smiles Turner research indicates approximately 20% is the more correct figure. These people will be included the current Bill's lower 10% establishment fee, 2% monthly interest cap regime, as recognised by the Delegation's recommended model and demanded by the consumer advocates.

"*The lack of competition is created because many borrowers are simply desperate to access money and do not feel they are in a position to look for a cheaper loan. This desperation, as well as a lack of awareness of safe alternatives to loans, allows lenders to effectively charge what they like*".

Delegation response: CALC welcomes the requirement that lenders and brokers include on their websites the "high impact statement" detailing alternatives, which is one answer to increasing awareness.

As discussed elsewhere in this submission, many borrowers are aware of competing lenders.

In addition, major new competition was emerging during 2008-10, until the uncertainties of the Commonwealth regime began to emerge, that continue to this day. Consumers will enjoy the opportunity of significant competition when the regulatory regime is settled and when and if the Committee, the Minister and the Parliament recognise a regime which protects the *"desperate and vulnerable"*, yet under which it is still viable to continue as a lender. This is provided by the Delegation's recommended model, with its simple modifications to the current Bill.

"*The reason the proposed cap will protect consumers is that it will make the shortest term loans less viable, encouraging lenders to offer longer term loans. As discussed above, the short terms of these loans are one of the key reasons they are so harmful. The object of any cap should be (sic) move the market away from the shortest term loans*".

Delegation response: This is a very disturbing conclusion. Longer loans have a significant negative potential impact for traditional short term borrowers, including:

(a) They keep the borrower in an indebted position for longer.

(b) The proportion of bad debts increases the longer the term of the loan. Smiles Turner industry analysis indicates that, for every 3 months loans are offered, the default/bad debt rate doubles. That means the traditional short term borrower will be encouraged to move into borrowing practices that significantly increase the possibility of default/bad debt and long term adverse impact on their important credit rating.

(c) Under the other consumer protection measures in the current Bill, that means an extended period where the consumer will not be able to increase their credit limit, borrow a second loan, or attempt any repeat or rollover borrowing. This means major inflexibility, in a longer term situation where unforseen circumstances are more likely to arise as the term is extended, simply because there is more time for them to occur.

(d) Lenders are disinclined to lend small amounts for extended periods. The default/bad debt ratio increasing factor, plus the administration cost of collecting much smaller amounts of repayment, are a major discouragement.

(e) Lenders will be compromised because, in being forced to lend more than the borrower wants, they are seriously failing to recognise the objectives and preferences tests prescribed as part of the National Consumer Credit Protection Act's responsible lending regime.

(f) Lenders will be faced with consumers having ever diminishing amounts left to pay, being a disincentive for lenders to chase overdue repayment, but collectively threatening the viability of the business.

(g) All the above means that lenders will be encouraged not only to lend longer, but to lend bigger. The result is borrowers forced to borrow more than they want, with greater potential for unmanaged indebtedness over a longer period of time, allowing for more unexpected adverse circumstances to intervene. All making repayment of the long loan a challenge.

(h) The existing *"desperate and vulnerable"* will not be provided with these longer and bigger loans, because they will still fail the "unsuitability" test. That means the non-*"desperate and vulnerable"* will be forced to adopt borrowing strategies that are more likely to place them in situations where they, too, will become *"desperate and vulnerable"*, when unable to pay their too big and too long loan.

(i) There is an increase in the aggregated cost of the credit, but the challenge still remains predominantly that of being able to repay the principal. The $500 loan for 4 weeks that, under the current Bill, costs $60 to borrow - if it becomes a 12 week loan, will cost $80. The consumers will be forced to pay 33.33% more for a longer loan they do not want.

Worse still, if consumers are forced to borrow $1,000 for 6 months, to satisfy a need for a $500 loan for 4 weeks, they will pay an extra $50 establishment fee plus an extra $110 for the 2% interest. This extra $160 means consumers will be forced to pay 3.66 times the cost of the $500 loan they really wanted.

Given the discussion above, it is interesting to note that the proportion of the total repayment that refers to the actual money borrowed, still dominates. On a $500 loan for 12 weeks, it is 86.2%. On a $1,000 loan for 6 months, it is 81.97%. The issue still remains - can they afford to pay the amount borrowed back - rather than can they afford to pay the fee and interest.

The CALC statement is an admission that their preference is to force the *"desperate and vulnerable"* into credit exclusion. For CALC, this is no change in status, as their later remark indicates - "*Access to harmful financial products does not amount to financial inclusion*".

It was also admitted by implication, during the evidence given by Ms Lowe before the Joint Committee on Corporations and Financial Services, where she stressed to that Committee that it was not an issue of consumer choice, but an issue of consumer "*circumstances*".

Unfortunately, while the existence of non-commercial alternatives are listed following this last quoted statement in the CALC submission, there is no detail as to how the resources of these alternative non-commercial sources of credit are going to increase in order to provide for these people. As a result, there is no indication of CALC's assessment of the amount of extra government assistance that will be required, if the current Bill proceeds unamended.

"*There is simply no credible evidence that (imposing a cap on costs for short term credit will create a market for illegal lending) is the case*".

Delegation response: This matter is considered in greater detail elsewhere in this submission.

Briefly - CALC's quoting a rejection of the Policis European study is unfortunate. The rejection cited was the work of a very political pro-cap activist and cannot be considered in any way objective. The limitations of the competing study have been ignored. In addition, CALC ignores comment from the 1999/2000 Queensland OFT investigators, media concerns published in the Adelaide Advertiser and expressed on ABC TV and radio in South Australia, and the growing physical evidence of bikie gang interest.

The following mention "*that there has not been a rash of illegal lending*" in NSW, Queensland and the ACT, following the introduction of their caps, is explained by CALC itself one page later, under their subheading "*Avoidance issues*". There was no market void created by the introduction of caps in those states and the ACT, for the illegal lenders to exploit, because the caps could and have continued to be legally avoided.

As Treasury admits in its RIS and as it admitted before the Joint committee in evidence, the current Bill has been drafted to carefully address those avoidance techniques, without actually "testing" whether or not they might allow the legal small amount, short term loan market to continue to be viable.

"*We are concerned that small amounts lent out as high-cost short term loans (at least when in isolation), may not breach the responsible lending test - that is, that they are "not unsuitable" for the borrower*".

Delegation response: This somewhat mirrors the abovementioned evidence, where consumer choice is not recognised by CALC, but only what CALC 'thinks is good for the consumer' appears to have legitimacy. With this Submission, the Delegation includes a 90 Day Assessment Form, used by at least 114 lending outlets and offices across Australia, to demonstrate how committed lenders are to acknowledging the mandatory responsible lending practices demanded by the National consumer Credit Protection Act 2009 and the ASIC regulators. This is typical of the approach adopted throughout the industry sector - the downsides of not doing so - the fines, gaol terms and loss of essential lending licence, ensure this. There is no "may not".

In addition, the rigorous nature of the mandatory assessment and approval process should allay all consumer advocate concerns - except where their clients have lied to the lenders.

Further, the accompanying comment "*that in general this borrower group is less likely than others to raise a dispute*", is at least somewhat contradicted by the fact that people do go to CALC, Legal Aid and the like, and the EDR schemes. As discussed previously, it is mandatory to include complete contact details, mentioned numerous times, in all loan contract documentation. These are free to the consumer and very easily contacted. In addition, lender counter staff can attest to many experiences that show low income borrowers have little difficultly complaining if they think they have been aggrieved, or if they are trying to get out of their borrowing obligations.

"*...enforcement for the responsible lending laws in this sector by the regulator would be extremely difficult, and would be unlikely to be adequate to change industry practice*".

Delegation response: This completely uniformed statement is exactly why Delegation supporters wish consumer advocates, Ministers and Treasury would actually visit a selection of lending outlets to see what actually goes on.

This is an attempt to dismiss the responsible lending provisions included in the National Consumer Credit Protection Act 2009.

There has been a massive change in industry practices since 1 July 2010. The reasons are all contained in the relevant legislation and regulations:

- punitive provisions, with massive fines ($220,000 individual, $1.1 million company);
- a considerable number of offences with gaol terms;
- criminal, rather than civil categorisation of many offences; and
- a mandatory licence regime that demands demonstrated compliance, or face suspension, cancellation, or refusal to offer renewal at the annual renewal time. No license means no business.

In regard to enforcement - it has never been easier to do so. Lenders have to keep a report of all their credit assessments, with all details and copies of all documents collected and used in the assessment, for 7 years. Compliance with responsible lending does not require substantial, if any, involvement by a complaining borrower, just a critical assessment by an ASIC compliance officer, following a simple inspection of the lenders' files. All the reputed 167 ASIC officers have been especially recruited and trained just for this post-1 July 2010 task.

"*We received a number of case studies of expensive loans given to customers despite clear proof of ongoing financial stress*".

Delegation response: This issue is explored in greater detail elsewhere in this submission.

Briefly:

- "*a number*" becomes 12, because that is all that CALC was able or prepared to published (actually 10 - see below);
- "*expensive loans*" - by CALC's assessment alone; and
- "*clear proof of ongoing financial distress*" - not supported by at least 7 of the case studies. Further, the "*proof*" in the relevant case studies only emerged after the assessment process was completed and sometime after the loan commenced, when the borrower could have been looking for an excuse not to fulfil their contractual obligations. This does not take into account the 2 which were bogus, and were found not to relate to the lenders named in the "*case studies*" at all.

Quoting the RIS - "*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*".

Delegation response: Very few lenders offer single repayment loans. Further, it would be useful if the Committee noted that this most unfortunate statement was written:

- no longer than 4 months after the responsible lending measures were introduced;
- without any review of the results of the lending measures;
- without any Treasury research;
- without any visit, by any Treasury, officer to a lending outlet or office;
- at least 2 months before ASIC commenced its survey and review of payday lending, which still has to produce a final report;
- in the absence of any consumer advocate or academic research conducted post July 1; and
- in total contrast to the information the industry provided Treasury in a number of submissions to the August 2010 Green Paper, with those submissions being the platform on which Treasury wrote the RIS.

"*Unfortunately, the caps on cost of credit that exist in Queensland, New South Wales, and the ACT have been subject to a number of avoidance techniques by lenders*".

Delegation response: As Treasury identified in its RIS - while referring to respected UK Government-sponsored studies that found the same outcome - if government sets the caps too low, one result will be lenders assessing that they cannot remain viable under the prescribed cap and attempting avoidance.

It is ironic that CALC offers this comment, when CALC and its colleague consumer advocate organisations were at the forefront of the pro-48% campaign in those states and the ACT, and were repeatedly told by lenders that they could not afford to lend at 48% and that such a cap would drive them out of lending, if it could not be legally avoided.

"*We recommend that the commencement date for Schedule 4 of the bill be 1 June 2012. (We see no reason for delay in commencement of these provisions)*".

Delegation response: This statement is made without any research as to the impact of the fee and interest rate provisions being undertaken by CALC, Treasury or academics. It is also made in a consumer advocate environment that assumes lenders will be prepared to lend at a loss, just to satisfy the 10%, 2% and 48% inclusive regime.

Further, this statement generally assumes there will be no credit exclusion for those who can no longer obtain loans from the commercial sector, presumably after they have all gone into bankruptcy and insolvency, because the non-commercial alternative sector will be able to accommodate them. This assumption is also made without one element of research from CALC, Treasury, or the academics, to satisfy themselves that this sector has the necessary capacity.

As indicated extensively elsewhere in this submission - the non-commercial alternative lenders, all in the "not for profit" sector, do not have the capacity either individually or collectively.

The 2011 Budget has come and gone without the necessary funding. That leaves it all to the 2012 Budget, which will not be in time to satisfy this recommendation - a recommendation that will require a substantial investment by the government, as discussed elsewhere in this submission - long before the 2012 Budget provisions take effect.

The Delegation has not responded to the various additional regulation CALC seeks, because the Minister has made it very clear, in person to the Delegation and to other industry representatives, that he will not welcome major additions and structural changes to the current Bill.

The CALC Supplementary Submission

As noted above, the CALC supplementary submission to the Joint Committee, dated 28 October 2011, did not make any criticism of the Delegation's suggested modifications to the current Bill by way of simple and limited additions, while substantially criticising the other representative organisation's alternative model.

Unfortunately, in attempting to criticise the other organisation, the supplementary submission failed to add essential clarification to the issues it presented. The Delegation considers that it is important for the Committee to be aware of some of this missing essential clarification. We quote the submission in the first instance and then follow with our concerns.

"*Typically, short term loans in Australia are about $200-$500 paid back over a period of two to four weeks*".

Delegation's concern: While a substantial number of loans are in this range, with lenders reporting averages of $286 to $325 for payday loans, it is important to observe that the current Bill negatively impacts on all loans up to $5,000. The $200-500 loan is generally a payday loan, which is the focus of the consumer advocates' concerns, and the consumer advocates' professional experience is generally with loans at the smaller end of this spectrum. However, up to 10% of the loans covered by the current Bill are not in that smaller payday loan category.

"*For a one month loan the proposed cap (10% plus 2%) would be the equivalent of an annual percentage rate of 144%*".

Delegation's concern: Quoting just a percentage rate provides an opportunity to include a seemingly large number - 144. However, in the context of loans that rarely have terms anywhere near 12 months, it is important that the Committee have other associated information before them.

While CALC claims 144% is the reducible annualised rate for a simple interest calculated 10% plus 2% of principal, as provided in the current Bill, it does not mean that, in dollar terms, the consumer is paying the full 144%.

It is interesting to note that CALC has, in fact, miscalculated. For a typical payday loan of $300, over 4 weeks, the $32 fee would amount to an APR of approximately 218% if paid weekly but, 183% if paid fortnightly.

Because the CALC loan is for one month or less, the amount paid is actually one twelfth of that annualised interest. The Delegation is appalled that one of the champions of the almost useful APR concept appears to demonstrate no knowledge as to how it is calculated, with the 144 figure simply being a simplistic and incorrect 10 + 2 (1 month) x 12 (for the year).

The calculation difficulties that led to CALC's error are a substantial reason why the APR regime should be abandoned.

The following calculations assist in providing clarification and a more comprehensive perspective:

- In the CALC example, under the current Bill, the consumer will pay $24 for the $200 loan and $60 for the $500 loan, whether borrowed for 2 weeks or 4 weeks.
- That is 12% of the principal.
- In other words, the consumer has to pay back a total of $224 on a $200 loan - the total cost of the credit being $24, which is 10.71% of the total repaid. That means 89.29% of that $224 amount is repayment of the actual principal borrowed. Similarly, 89.29% of the $560 amount repaid on the $500 loan is actually repayment of the money borrowed.

"*This* (the 144% being the annualised 10%, 2% cap in the current Bill) *is 3 times the return to lenders compared to the current legislative position in Queensland, NSW and the ACT*".

Delegation's concern: There is no clarification included in the supplementary submission that none of the lenders are operating in those jurisdictions under the legislated 48% cap, as a number of witnesses told the Joint Committee on Corporations and Financial Services on 24 October 2011 and as Treasury admitted in its RIS dated June 2011. CALC even acknowledges this later in their submission.

It would be most unfortunate if the Committee was to misunderstand and assume the 10%, 2% model in the current Bill provides a triple increase in income for lenders, as CALC assumes. As every lender witness questioned and as every lender or lending organisation presenting submissions has demonstrated, this 10%, 2% is a substantial reduction compared to the calculations currently employed.

(If) "*…the establishment fee in the proposed cap should be increased …the bill will not achieve its policy goal of impacting small amount loans in Australia so that they are not unaffordable for borrowers and do not lead to debt traps*".

Delegation's concern: While the delegation is not proposing any increase in this establishment fee for loans to the *"desperate and vulnerable"*, any such proposed increase must be viewed in dollar terms, as in point 2 above.

For a loan up to 4 weeks -

Loan amount and establishment fee	Annualised interest rate	Dollar amount, paid as establishment fee plus 2% monthly fee	Percentage of amount repaid that is fees & interest (including 2% monthly fee)	Percentage total repaid that is principal
$200 at 10%	144%	$20, plus $4	10.71%	89.29%
$200 at 20%	264%	$40, plus $4	18.03%	81.97%
$200 at 25%	324%	$50, plus $4	21.26%	78.74%
$200 at 30%	384%	$64, plus $4	24.24%	75.76%
$500 at 10%	144%	$50, plus $10	10.71%	89.29%
$500 at 20%	264%	$100, plus $10	18.03%	81.97%
$500 at 25%	324%	$125, plus $10	21.26%	78.74%
$500 at 30%	384%	$150, plus $10	24.24%	75.76%

"*…if this argument is accepted* (an increase in the establishment fee), *the bill will not achieve its policy goal of impacting small amount loans in Australia so that they are not unsuitable for borrowers and do not lead to debt traps*".

Delegation's concern: The above demonstrates why it is the ability to borrow and the granting of the actual loan, rather than the actual fees and interest incurred on the smaller loans, that primarily gets borrowers into trouble. The fees and interest obviously add to the debt burden, but the primary challenge still lies in actually repaying the amount borrowed itself.

Simply reducing the smaller component (the fees and charges) of the total amount that has to be repaid, is not going to be the panacea for which the consumer advocates are hoping. A minimum of 75.76% of the amounts in the examples discussed by CALC, in their supplementary submission, have nothing to do with the cost of borrowing.

If you take the most prevalent average payday loan of $325 for 4 weeks - at a 10% establishment fee ($32.50) plus 2% monthly permitted flat rate interest ($8 - there is no apportionment under the current Bill), you have a total cost of credit of $40.50. The borrower is contracted to repay a total of $365.50. Of that total amount, 11.08% is fees and interest and 88.92% of that is repayment of the principal (amount borrowed).

Even if you increase the establishment fee to 30% of the principal ($97.50) plus monthly interest of 2% ($8) - total cost of credit $105.50 - the borrower is contracted to pay back

$430.50. Of that total amount 24.5% is fees and interest and 75.49% is actually repaying the $325 the lender gave the consumer.

On an average loan, at the highest suggested establishment fee presented by another industry representative organisation, ¾ of the repayment challenge is still created by the actual dollars borrowed - NOT the fees and interest.

That is why the Delegation continues to be concerned that the consumer advocates are failing to examine the impact of the post-1 July responsible lending provisions, which inhibit unwise lending, on the basis of the inability to repay the principal.

They continue to focus on the payment of the cost of the credit. The hardship that has to be primarily avoided is the hardship created by the legal requirement to repay the actual amount borrowed - that means discouraging lenders and borrowers from entering loans that cause harm to the consumer - loans that they simply cannot afford to pay back, almost regardless of the cost.

If the cost of the establishment fee and the monthly interest under the current Bill is the issue, the Delegation acknowledges that:

- there are low income recipients who should never receive a loan, unless they can afford to repay both principal and a regulated below cost interest rate;
- commercial lenders should not be able to lend normal commercial loans to these low income recipients; and
- their borrowing, still under the rules of responsible lending, should be undertaken by commercial lenders prepared to cross-subsidise from their profitable loans to non-desperate and vulnerable borrowers; or
- they should be catered to by the alternative non-commercial lending sector, with substantial government assistance.

What both the Minister and the consumer advocates have got to accept is that the issue is a welfare and minimum income issue, and tinkering with the interest rates and fees only addresses a negligible part of the problem.

Under the regime included in the current Bill, 89.29% of the repayments associated with the small amount, short term loans that most concern the Minister and consumer advocates, is repayment of principal.

This concern does not change, no matter what interest rate and fee limitations are imposed by regulation and statute. If one industry representative organisation gets its way, the amount of the total repayment that constitutes repaying the actual money lent, will still be 75.76%.

Until their access to greater income is suitably increased, the *"desperate and vulnerable"* consumers, of concern to the Minister and welfare groups, simply should not have access to credit. Although credit inclusion may be regarded as a right by some, it comes at a price. For these people, any price is too expensive, because they cannot even afford to pay back the principal.

Grants, not loans, must be included in the alternatives the Minister and consumer advocates are so confident can provide the necessary assistance, in place of the commercial lenders the current Bill forces out of the market. As a consumer advocate witness admitted in evidence to the Joint Committee, the current Bill does not come with any inclusions that recognise this reality.

It is very unfortunate that the opportunity to expand the current Inquiry being undertaken by the Senate Economics Committee, "*Finance for the not-for-profit sector*", has not been used to best advantage in this context. Given that most of the alternatives championed by the Minister and the consumer advocates involve provision of loans and services by not for profit organisations - the very organisations that will see a 100 fold increase in demand when the commercial lenders are forced from the market under the provisions of the current Bill - this is most unfortunate.

The Delegation emphasises, if repaying the principal is the issue, then no loans should be offered to the Minister's *"desperate and vulnerable"* and assistance must be provided by increasing the income available to the person, or providing welfare assistance.

Whether the issue is paying the fees interest or repaying the principal, it should not lead to all lenders and borrowers being regulated as if the entire payday and micro-loan market consists only of *"desperate and vulnerable"* borrowers. As the current Bill stands - not only will the commercial lenders not be lending to the *"desperate and vulnerable"*, they will not be lending to almost anyone else.

"*...the majority of borrowers are repeat borrowers - some of them borrowing many times over the period of a year*".

Delegation's concern: The use of the term "*majority*" is most disturbing and presents a totally inaccurate picture of borrower reality. The majority of those borrowers who turn to consumer advocates and their associates for help may be repeat borrowers, but that is certainly not the case when looking at the whole borrowing population. For example, in the 2010 Smiles Turner consumer study 76.55% of the respondents had never used a repeat, or rollover, facility to pay off an existing loan. In addition, a further 13.6% had taken one repeat in the preceding 12 months.

The RMIT University "*Caught $hort*" report, quoted by CALC, refers only to the number of loans "*ever*" taken out and, while it considers repeat borrowing consumer strategies, there is no mention of any activity being continuous for a full year.

The Delegation notes the allegation that "*The product itself is designed to encourage repeat borrowing*" and the concern for the amount required from a single aged pensioner's benefit to repay a $300 loan.

The Delegation's comment: These concerns are addressed, with agreement between CALC and the Delegation that the provisions of the current Bill should be left in place for the *"desperate and vulnerable"* and the net income cap suggested by the Delegation be included, in an effort to protect people such as the pensioner cited.

National Legal Aid

The Delegation is pleased to note that the submission to the Joint Committee on Corporations and Financial Services submitted by National Legal Aid, dated 14 October 2011, is clearly referring to the smaller payday loans and not microloans.

It is pleasing that Legal Aid has obviously recognised that the provisions in the current Bill it supports are appropriate for smaller payday loans, but not referable to microloans.

The Delegation is also pleased to be able to inform the Committee that 4 of the 5 case studies quoted would have been addressed by those provisions in the current Bill that the Delegation supports and recognises in its recommended model.

A view cannot be provided in regard to Mrs K's situation, in Case Study 2, because there has been no detail provided as to her income earning circumstances.

Good Shepherd Youth and Family Services

The Delegation has huge respect for the outstanding work the Good Shepherd Youth and Family Services organisation undertakes. However, the Delegation is aware of the Good Shepherd response to a question taken on notice at the 24 October 2010 Joint Committee on Corporations and Financial Services hearing and is obliged to comment.

Good Shepherd:

80-90% of people they speak to are on Centrelink benefits.

In circumstances where there was an absence of time to undertake an audit of case files, the following comments were provided:

"*...approximately 30% of all Good Shepherd financial counselling clients are estimated to have payday loans*".

Delegation comment: While the Delegation would be surprised if there were not a number of clients with payday loan histories, this statement does not assist any evidentiary based evaluation of the contribution of these payday loans to the circumstances that encouraged the client to have contact with Good Shepherd. We simply gain no information as to what other debts each client has and the relative importance of the payday loan/s.

"*...many clients do not mention their payday loans because they are ashamed to admit they have them*".

Delegation comment: There is no statistical information to indicate what "many" means, nor is there any comment on other information that is reluctantly provided to the service. The lenders are constantly dealing with clients of welfare and, more particularly, free legal services who have shown great reluctance to admit other equally important things, such as the fact that they may have lied when they took out their loan. Veda Australia has recently reported that 10% of all loan applicants lie when seeking a loan. In the writers' experience as advisers to lenders for over a decade, in excess of 50% of complaints that lenders bring to their attention involve a substantial lie on the part of the borrower.

"*...many of the clients from newly arrived communities do not understand the payday loan contracts as no interpreters are offered by the lenders*".

Delegation comment: Lenders are not without experience of borrowers claiming language ignorance to avoid their contractual obligations. However, on the basis that there are genuine cases of language problems amongst the Good Shepherd clients, and we do not doubt the Good Shepherd organisation's assertion, it is useful to remember that there are Commonwealth government interpreter services to access. If a borrower does have a language problem, it would seem appropriate that they ask a member of their newly arrived community with a better command of English to accompany them, and any implied expectation of lenders providing an interpreter service must be considered in the context that Good Shepherd is supporting the current Bill, which will devastate lender profits.

It should be noted that, to impose an interpreting obligation on lenders, exposes them to further costs that, under the current Bill, cannot be charged as an extra to the consumer and, in any event, that consumer may be deemed to be "unsuitable" for the loan.

"*...anecdotal evidence suggests that approximately 50% of clients with gambling problems have a payday loan*".

Delegation comment: No lender deliberately lends to fund gambling. With default rates up to 10% and bad debts at 3%, lending is a big enough gamble as it is. In all the self-administered consumer surveys conducted by Smiles Turner, it is interesting to note that only 2 people have admitted to borrowing for gambling - one South Australian in the 2006-7 National survey and one in the November 2010 Consumer Snapshot.

The Delegation considers the following organisations' publications and attempts to highlight how little statistical information - on such incredibly important areas - has been gathered and included.

Good Shepherd Youth and Family Service's submission to the Committees

The Delegation does not doubt that this organisation has considerable "*practice experience in financial inclusion and financial capability programs*", as it claims in its submission. However, the Delegation's review of the Good Shepherd organisation's submission to the Committee reveals only 1 person, in 1 case study, where the circumstances may reflect an issue actually considered by the current Bill.

CALC submission to both Parliamentary Committees

Statement: "*These (payday) loans are causing significant harm to consumers...*".

Statistics: Concerning those actually harmed - nil, unless you count the 12 (10) "*case studies*" considered in detail elsewhere in this submission.

CALC evidence to Joint Committee, 24 October 2011

Statistics: Mention that the "*Caught $hort"* report" referred to 50% of borrowers having at least 10 loans (but only in reference to industry growth).

In regard to the Nab project - 90% of applicants were turned away because of the purpose of their application - recurrent, everyday living expenses.

National Legal Aid submission to Joint Committee

Statement: "*The following case studies illustrate the exploitive practices of the payday lending industry...*"

Statistics: 4 payday case studies, one study that could be either payday or, more likely, a micro-loan case study, with insufficient detail provided to determine and no way of verifying their accuracy.

National Legal Aid Evidence to Joint Committee

Statement: "*For a $100 loan the repayment is about $135*".

"*If you borrow at 240% it is probably not going to be too good*".

CALC NSW Submission to Parliamentary Committees

Statement: "*We consider that all of the areas of proposed reform are important and needed*".

"*The consumers who use this type of credit are often desperate and on a low income (usually Centrelink)*".

"*Consumers who use this type of credit often get caught in a debt trap*".

Statistics: 1 credit contract "*case study*" - on the detail provided, not possible to determine whether a payday loan or a micro-loan, even though for a loan of $1,000.

Redfern Legal Centre

One small loan credit contract case study.

Financial Counselling Australia Submission to both Parliamentary Committees

Statement: "*Based on the survey sample, a conservative estimate is that this group of financial counsellors had collectively assisted more than 2,5000 clients in the past 12 months*".

The Delegation notes that this organisation at least attempted a contemporary survey. Unfortunately, this survey was completed primarily at various conferences, during a break in proceedings or at the end, and "*the majority of respondents were not in their offices when the survey was undertaken*".

That meant the majority of the responding financial counsellors could not access their files and had to rely on their memory, which might explain the reason for questions seeking a broad range of numbers to be included, e.g. "less than 5, 5-10, 11-15, 16 or more", when it would have been very useful to have a response calculated more precisely. The submission also notes that those counsellors who did have access to their files when completing the survey, "*probably*" still made a guess.

Statistics: 341 counsellor respondents, over a period of the last 12 months.

Given the statement above, the submission suggests the average number of clients with payday loans, seen by each counsellor, was 7.33 clients over the last 12 months. The Delegation notes that this figure constitutes an average of 0.14 clients per week, per counsellor.

The submission noted -"*24% of financial counsellors had seen less than five clients with payday loans*" (that is 0.096 clients per week, on average). "*At the other end of the spectrum, 21% of financial counsellors had seen 16 or more clients with payday loans*" (that is - 0.307 clients per week).

Unfortunately, no information was given on the 6 to 15 client range.

In regard to repeat borrowing:

- Of the total of all counsellors who attempted the survey form 195 (57.18% of participating counsellors) noted that "*most*" or "*all*" their clients were repeat borrowers.

- As best can be calculated, on the information available, assessing the 45 counsellors that said "*all*" clients were repeat borrowers - all at 7.33 clients - and the 100 who indicated "*most*" clients were repeat borrowers - assessed at 6 clients each - that means 1,228 clients (49.12%), seen over the last 12 months, were repeat borrowers.

It is noted that repeat borrowing was defined as "*the payday loan had been rolled over immediately or the client had paid the loan back, but took out another loan very soon afterwards*".

In regard to multiple loans borrowed at the one time by clients:

- 72 counsellors reported "*most of them*" or "*all of them*" (being clients) had multiple loans. That constitutes 21.11% of the counsellors participating in the survey which, accepted as credible, extrapolates very roughly to a possible 528 borrower clients.
- To those we have to add the number that constitute "*some of them*", as nominated by 100 of the participating counsellors. If we assume 2 out of the average 7.33 clients as "*some*" - 200 borrowers - that means there were 728 clients in this category, or 29.1% of the total client numbers visiting the counsellors in the last 12 months.

While 341 participated in the survey, the submission indicates that there are 870 counsellors in Australia. In the above analysis, the Delegation used the figure of 2,500, because that was a concluding figure offered in the submission.

However, due to the way the survey was conducted, the submission notes that the number of clients was in the range of 2,285 and 3,269. Using those figures:

- Average number of clients per counsellor participating in the survey, or per last 12 months - between 6.7 and 9.59.
- If we project this to reflect a possible number of clients for all 870 counsellors in Australia (number as stated), per last 12 months, the range is between 5,829 and 8,343.

The Delegation appreciates that Financial Counselling Australia included some information on the non-commercial sector's capacity to help people. This is discussed elsewhere in this submission.

Anglicare Victoria and Sydney - Evidence before the Joint Committee

Statistics: About 10,500 people - 72.5% relate to client debt problems, 50% relate to creditor issues - and creditors not being willing to negotiate.

Later in their evidence, of 16,000 people seen by their service, 1,000 to 1,500 are "*payday lender issues*".

755 of all clients are Centrelink benefit clients.

Anglicare Victoria - Submission to the Committees

The Delegation notes Anglicare Victoria's submission mentions that "*Over the past twelve months... (they have) provided financial counselling to 10,553 people facing financial hardship*", such involving "*casework, advocacy and community education*".

The service's "*Financial counsellors assist vulnerable and disadvantaged people who typically have affordability problems with living expenses, paying bills or addressing other financial commitments*". The Delegation would assume the latter may reflect the current Bill's inclusions, but no further information is provided, apart from that within a table headed "*Breakdown of Anglicare Victoria client debt related problems in 2010-2011*", which includes: Centrelink 18.2%; "*Creditor harassment*" 13.5%, and "*creditor, inadequate, non negotiation*".

There is no further clarification or quantification included. This prevents any quantitative analysis of the people presenting to the service's financial counsellors with financial problems caused in whole, or considerable part, by payday or microloans.

Statistics: Only 1 anecdote, concerning 1 client, appears to relate to the provisions of the current Bill.

Anglicare Sydney - Evidence before the Joint Committee

Statistics: 50% of 180 microfinance clients (90) over the last 12 months are payday borrowers.

90 % of all clients are on Centrelink benefits.

Anglicare Sydney - Submission to the Committees

Anglicare Sydney's submission again does not provide any statistical evidence as to the number of consumers with financial problems due in whole, or part, to payday or microloans.

Statistics: Anglicare Sydney's submission includes mention of "*ER data*" which reveals that, since July 2007, *"across all service sites there have been 10,304 visits in relation to debt*". We note that constitutes 49.54 people per week. Unfortunately, there is no breakdown of these figures.

The submission includes only 1 case study where the circumstances appear to be within the current Bill's content.

Total Number of Consumer Advocate Clients - 1.327% of total borrowers

The above statistics provided by the consumer advocates add up to 9,955, including the case studies. These 9,955 people will always be important but, on these statistics, the consumer advocates are attempting to impose a current Bill that has been designed, at best, to assist the *"desperate and vulnerable"* 1.327% of the total number of small amount, short term borrowers - leaving the 98.673% without the lender of their choice.

Significantly, this majority group are not in any way represented by the consumer advocates.

The Research on Which the Consumer Advocates Rely

The consumer advocates rely on the following research. Unfortunately, when you analyse the reports of their unsubstantiated assertions and contradictions, you are left with very little evidence or indication of actual "*harm*":

RMIT University "*Caught $short*" Interim Report, August/September 2011.

"Evidence" of financial harm included in the report:

- Up to 44% of respondents engaging in some prescribed form of repeat lending that the researchers regarded as unacceptable.
- As an illustration of the negative impact of payday lending - 26% (29) of respondents were sourced from financial counsellors and other community organisations.
- 36.6% (41) commented on unspecified "*repayment problems*". Note, only 10.6% of those sourced from the general borrowing population made such a comment.

There was no other evidence of actual harm. A careful analysis of the 122 respondents leaves 12 borrowers (14.45%) who may have needed the provisions in the current Bill.

There were 122 respondents in all, 112 being payday borrowers who provided the above information.

Z Gillam, CALC, "*Payday Loans, Helping Hand or Quicksand*". Researched 2008 and 2009, publication 2010.

"Evidence" of financial harm included in the report:

- The researchers were concerned that 28.1% of respondents were in part time and casual employment and 21.9% unemployed, but there was no evidence that actually linked them to some form of "harm".
- 23.4% of respondents had incomes below $20,000.
- Larger loans and credit cards get borrowers into trouble, rather than the small amount borrowed through payday loans.

- 26% of participants had in excess of 2 loans in the past 18 months. There was no evidence given as to whether or not these loans were sequential or caused "harm" to the borrower.
- Money management problems, largely in the Geelong area, with some evidence in the Fitzroy area, associated with the 'in-depth' home interviews or group categories primarily conducted in those suburbs.

448 people responded to the internet survey. A careful analysis of the report reveals that 23.4% would have gained some advantage from the provisions in the current Bill. However, this figure cannot be extrapolated for the entire borrowing population, given Geelong's troubled circumstances and the disproportionate number of respondents from Geelong.

D Wilson, CALC, "*Payday Lending in Victoria*", 2002.

The Delegation has difficulty finding substantial "Evidence" of financial harm included in this report.

72 actual borrowers were canvassed, plus 12 in-depth interviews were conducted, with 1 from the actual borrowers and 1 referred. It was unfortunate that most of the respondents were interviewed for only 3-5 minutes.

The total number of respondents used, all surveys above - just 654 people.

The Delegation notes that, if the surveys had been undertaken in 2010-2011, this number would have constituted only 0.087% of the current total number of small amount, short term loan consumers.

Site Inspections Overlooked

The Minister and his Ministerial predecessors and their advisers, just like every State and Territory Minister and their advisers before them (except Victoria in 2006), have never bothered to actually visit a lender and see what goes on at the customer interface, or look at any lender's audited profit and loss statements.

The Delegation does acknowledge that the Hon. Nick Sherry, when he was the Minister responsible, visited the USA and enquired into payday lending in that country, arriving back in Australia to declare his opposition to interest rate caps.

Significantly, after imposing a mass of new regulation on the lenders since 1 July 2010, and ever increasingly, with new Austrac requirements introduced on 28 June 2011 and new disclosure requirements from 1 October 2011, not one Commonwealth Minister has bothered to pay a visit to any lender - anywhere.

Concerning APRs

While the Delegation is of the view that publication of APRs is inappropriate, as they are not considered or appreciated by consumers, publication is regarded as being of value by the consumer advocates. That being the case, the 48% interest and establishment/ administration fee amounts could be presented as an APR on all websites and on noticeboards in the public areas of lending outlets, as a further opportunity for comparison.

For the consumer who is *"desperate and vulnerable"*, adoption of any one of the proposed Section 32A(2) options would be in addition to the provisions for small loans in the current Bill - a ban on rollovers and refinancing, the ban on having more than one contract at any one time, the ban on obtaining an increase in the credit limit, the ban on debt consolidation and the draconian and completely unworkable 2-tier interest rate/fees and charges cap.

All this is supervised by ASIC, which can review for credit legislation compliance as well as corporations legislation compliance, and determine whether you receive, or get to keep your licence.

As the Committee members would have noted, the small amount, short term loan sector does not qualify as an outstanding example of government deregulation.

It is already drowning in regulation and does not require any more, let alone that with the complexity and anti-lender, pro-defaulting consumer content of the Section currently being considered by Treasury.

COAG Review

The delegation reminds the Committee that, whatever the Committee recommends and whatever legislation is subsequently passed, there must be a review of the measures within 2 years.

The terms of the 2009 National Credit Law Agreement between the Commonwealth, States and Territories, requires the Commonwealth to commence a review of the operation of the National Credit Law no later than 2 years from commencement.

This provides an opportunity for the Committee to adopt the Delegation's suggested model knowing that it will be thoroughly reviewed in 2 years' time. In contrast, if the current Bill is passed unchanged, a 2 year review period will not be soon enough to repair the massive damage it will cause.

This would also allow a test period for the Minister's preferred consumer protection provisions directed towards assisting the *"desperate and vulnerable"*, while leaving the existing supply structure intact and encouraging greater competition within the sector for the non-*"desperate and vulnerable"* consumer. This test period would give a chance, not only for the amended Bill's provisions to play out, but also for ASIC to monitor and report to the Government on the impact of the existing regulatory regime. Some of it will be barely 16 months old, some of it 10 months old and some of it barely 1 month old.

In contrast, if the current Bill is recommended the existing supply structure, which has taken over 10 years to establish, will be destroyed and an almost complete rebuild should be expected to be necessary in 2 or 3 years time.

Criminal Elements

Contrary to some consumer advocates' denials - in the context of inadequate alternatives, if the Bill is passed in its current form the emergence of a criminal element associated with small amount, short term lending <u>will</u> occur in 2013, particularly in the absence of the necessary $3.2 billion Government funding. This statement is made with the knowledge that there will be up to 750,000 individuals, most of whom will be left with nowhere to go to borrow as they had in 2010.

In 2006-7, state by state results of a national survey provided the following numbers of people with nowhere else to go:

Queensland	NSW	SA	WA
71.6%	76.7%	72.1%	81.6%

The Delegation believes that, while the assessment of respondents may involve an element of optimism on the part of those who nominated one or more credit providing alternative, it is nevertheless significant that, in the 2011 consumer survey, 71.6% indicated that they would have nowhere else to go to borrow money if the lenders were to close.

The Delegation reminds the Committee:

(a) In 1999/2000 the Queensland Office of Fair Trading's study into payday lending in South East Queensland warned of the danger of criminal lenders emerging if payday lending was outlawed.

(b) Queensland bikie gangs now have interests in 2 pawn broking outlets in the Sunshine Coast region and also in 2 on the Gold Coast.

(c) While discussion and enquiry concerning a 48% cap was continuing in South Australia in 2006/7, bikie gangs were moving in as lenders and achieved Adelaide Advertiser and ABC radio media coverage (on and around 29 July, 2007). They even established an outlet in suburban Salisbury in the, then, Parraboules Shopping Centre and conducted business openly until the Centre was demolished.

(d) The Vietnamese/Australian and Lebanese/Australian syndicates that provide loans to gamblers in the casino and larger registered clubs in NSW, already have the expertise to extend their services.

(e) One of the reasons the UK Government has now rejected 3 attempts to reintroduce interest rate caps on small amount, short term loans, has been a concern that such would open up opportunities for the criminal element.

(f) The international research company Policis' studies of the capped environments in Europe, all indicate criminal lenders existing outside the legislated regimes.

(g) In the USA, where some 13 states have adopted a ban, or severely curtailed payday lending, academic research reveals a substantial increase in bounced cheques (fraud) and out of jurisdiction borrowing (non-compliance). These illegalities are being accompanied by a substantial increase in bankruptcies.

In March/April 2011, 51% of the responding lenders indicated that they knew of an illegal lender. In regard to those who knew of such a lender, the average number of illegal lenders known was 3.3%. In regard to all lenders responding, including those who did not know of an illegal lender, the average was 1.7 illegal lenders.

International Studies

International studies have supported the above views, particularly from the International/ World Bank affiliated Consultative Group to Assist the Poor (CGAP), in Donor Brief No. 18, May 2004, where researcher Ann Duval stated,

"*...though meant to protect consumers, interest rate ceilings almost always hurt the poor ...by making it hard for new microfinance institutions to emerge and existing ones to stay in business... By forcing pro-poor financial institutions out of business, interest rate caps often drive clients back to the expensive informal market where they have little or no protection*."

CGAP's Consultative Paper No. 9, September 2004: Introduction, reported:

"*Historically, governments have used mandatory interest rate ceilings.... Unfortunately, this often hurt rather than protects the most vulnerable by shrinking poor people's access to financial services. Interest rate ceilings make it difficult or impossible for formal and semi-formal micro-lenders to cover their costs, driving them out of the market (or keeping them from entering in the first place). Poor clients are left with no access to financial services or must revert to informal credit markets... which are often more expensive.*"

The Delegation was particularly concerned to read of CALC's dismissal of the possibility of a prohibitive cap leading to the creation of a market for illegal lending.

At page 8 of the CALC submission to the Committees, CALC claims that "*There is simply no credible evidence to suggest that this is the case*". As discussed in this Submission's review of the CALC submission, CALC has ignored the realities of lending in Queensland, NSW and the ACT, where the imposition of the 48% inclusive cap has been legally circumvented by lenders, thus not leaving any void for the criminal element to exploit.

In addition, CALC's claim that "*both the findings and the methodology of this survey have since been widely questioned*", in regard to UK consultancy firm Policis' international research, is not accompanied by a disclaimer that CALC was merely repeating criticism presented by an interest rate cap advocate and campaigner, without further examination of the veracity of the claim. An example of such repetition without critical examination can be found at page 187 of CALC's 2010 report.

A careful examination of the methodology employed by Policis, in its international studies in question, will reveal that Policis employs a far more rigorous research methodology than has been demonstrated by CALC to date. Despite CALC's concern that it is "*not logically coherent*" to assume currently legal borrowers will "*turn to underground providers*", such belies CALC's description of the borrowers of concern as being *"desperate and vulnerable"*, particularly if the lenders they current approach not longer exist.

In a telephone interview with John Bracey, the President of the Australian Institute of Private Investigators, conducted on 23rd April, 2010, Smiles Turner was informed of the significant issue of people turning to petty crime and larceny when faced with a perceived desperate need for money.

Mr Bracey, who has a substantial practice constituting 95% criminal defence investigations (involving larceny and housebreaking) indicated that, in 90% of the cases in which he was involved, the defendant turned to crime not as a normal manner of behaviour, but out of desperation to get money not available from any other source. He noted that, while criminal defence investigations constituted approximately only 5% of all the Institute members' work, at Institute Conferences the members engaged in such investigations all reported a similar level of criminality generated by desperation.

Alternatives and the 'Not-for-profit' Sector Senate Inquiry

The Delegation is very concerned at the apparent lack of integration between the inquiry into "*Finance for the not for profit sector*", being conducted since February this year by the Senate Economics References Committee, and the short time frame, but major issue review of the Enhancements Bill, by both the Joint Committee on Corporations and Financial Services and the Senate Economics Legislation Committee.

With so much of the future successful implementation of the Enhancements Bill depending on the abilities and capacities of not for profit organisation alternatives, as consumer advocate after consumer advocate has emphasised in evidence and in submissions, it appears highly relevant that such be a matter of consideration for witnesses before and members of the Senate Economics References Committee.

The importance placed on not for profit organisations' abilities to cope, by the relevant Committee, is demonstrated by a total of 4 days of hearings being provided for that Inquiry.

It is to be noted that, while witnesses from the Department of Families, Housing, Community Services and Indigenous Affairs and Treasury gave evidence to the Senate Economics Reference Committee Inquiry into the not for profit sector, they were not the same officers who have been involved with the small amount, short term lending issue.

None of the consumer advocate organisations involved with the lending issue, or those non-commercial organisations that are nominated as the alternatives to commercial lenders, appear to have participated in that Inquiry.

This lack of involvement is of particular relevance, given that the "*Finance for the not for profit sector*" Inquiry's terms of reference included:

- "*the development of appropriate …retail financial products;*
- *Government actions that would support the potential for social economy organisations involved in the delivery of government services to access capital;*
- *Incentives to support investment in the sector;*
- *Making better use of the sector's own financial capacity - including …use of reserve capital;*
- *And other rated matters*".

This Inquiry follows a Productivity Commission report published in January 2010 which, amongst many others, examined the issues of:

1. community development organisations providing finance for on-lending;
2. community development banks; and
3. community development credit unions.

The Delegation considers that the non-commercial lending alternatives favoured by the Minister and consumer advocates come within the purview of this Inquiry and, like the Productivity Commission before it, this Inquiry has had no opportunity to examine the issue of a potentially $3.2 billion impost on the not for profit sector, if the current Bill is introduced unchanged.

It now appears that all three Committees will be reporting to the Parliament later this month (November 2011), within days of each other.

Review and Control Process

The Delegation reminds the Committee that both the *"desperate and vulnerable"* and the non-*"desperate and vulnerable"* consumer segments would continue to be protected by the responsible lending regime imposed by the National Consumer Credit Protection Act 2009 and associated regulations. In addition, the *"desperate and vulnerable"* consumers will also enjoy the current Bill's consumer protections provisions, thus satisfying the Minister's fundamental concern.

All consumers will continue to be protected by the already introduced "*enhancements*" included in the National Consumer Credit Protection Act and associated Regulations, plus other recent Acts.

The Delegation is disappointed that the existing substantial regulatory regime was not allowed to "bed in", before contemplating measures as those included in the current Bill. As the Committee would be aware, a regulatory revolution commenced on 1st July 2010 and continued with the introduction of further regulation on 1st January 2011 and 1 October 2011. Significant components of this revolution include:

1. Internal Dispute Resolution;
2. External Dispute Resolution;
3. Sections 178, 179 and 180 of the National Consumer Credit Protection Act, providing the opportunity for orders favouring the consumer -
   (a) for loss or damage compensation;
   (b) to vary a contract's terms;
   (c) to refuse the enforcement of contract terms;
   (d) to direct refunds; and
   (e) to declare the whole or part of a contract void.
4. The provisions of the ASIC Act, Part 2 Division 2, that now apply to microlenders, including:
   (a) the prohibition of misleading conduct;
   (b) the prohibition of unconscionable conduct;
   (c) the prohibition of unfair contract terms;
   (d) implied warranties of due care and skill; and
   (e) implied warranties of fitness for purpose.
5. Responsible lending requirements include:
   (a) the comprehensive mandatory issues of determining suitability;
   (b) undertaking reasonable enquiries and verification;
   (c) acknowledgement of the consumers' objectives and financial circumstances;
   (d) recognising situations of substantial hardship; and
   (e) additional disclosure obligations.
6. The provisions of the National Consumer Credit Code, including:
   (a) Section 16 - demanding a pre-contractual statement.
   (b) Section 17(4) - disclosure of the annual percentage rate, or rates, under the contract.
   (c) Section 17(7) - disclosure of the amount and number of the repayments.
   (d) Section 17(8) - disclosure of all credit fees and charges that are, or may become, payable under the contract and when each is payable.
   (e) Section 17(8) - disclosure of the total amount of credit fees and charges payable.
   (f) Sections 34 to 39 - the provision of statements of account.
   (g) Section 68(3) - provision of a default notice.
   (h) Sections 153, 154 and 158 - where advertisements contain any reference to cost, the annual percentage rate, and any fees or charges payable, must be included.
7. Disclosure documents including credit guides, quotes and proposals.
8. All of the above is underpinned by the Australian Credit Licensing system, which demands compliance under the ruinous threat of suspension, cancellation or refusal to renew the essential licence needed to stay in business. In addition, licensees are required to conduct their business, as a major condition of their licence, "efficiently, honestly and fairly".

9. It is now mandatory for the following:
   (a) Annual audits - to be submitted to ASIC;
   (b) Professional indemnity insurance;
   (c) Continual professional development for managers and staff;
   (d) Financial resource minimum requirements;
   (e) Fit and proper person's test, for key people;
   (f) Risk management systems;
   (g) Penalties frequently expressed as criminal, with fines frequently up to $220,000 for the individual and $1.1 million for the company; and
   (h) ASIC misrepresentation and unfair contract provisions.

All the above has been/will be implemented at huge cost to the lenders, particularly in areas such as changes to documentation and associated processes. The cost of the essential professional compliance advice has been made more challenging with the adoption of a new set of terminology to replace long-held industry terms. These have had to be replaced in all documentation, with the new terminology lengthening the documents considerably and staff trained specifically as to the changes. These include:

- Lender - now called "Credit provider";
- Broker - now called "Credit assistance provider";
- Agent - now called "Authorised credit representative";
- Quote - now called both "quote" <u>and</u> "proposal disclosure document";
- Company profile - now called "credit guide";
- Credit manager - now called "product designer";
- Copy of contract - called a "Pre-contractual Statement";
- Future possible fees - are now "unascertainable fees"; and
- An approved borrower has to be "not unsuitable".

ASIC Now in Play

Consumers now have the opportunity to complain to ASIC, with all its compliance powers and multi-million dollar budget to implement its supervision of the microlending sector.

The opportunity of "*exploiting vulnerable targets, ripe for exploitation*", with conduct that offended "*good conscience and fair play*", as considered in *ASIC v National Exchange Pty Ltd* (2005) 148, is significantly curtailed, with the "*unconscionable*" provisions of the ASIC Act at Section 12CB(1).

As the Queensland University of Technology survey and report, "*Phase Two of the National Credit Reforms Examining the Regulation of Payday Lenders", March 2011,* noted, at page 37:

"*In the context of a pay day loan, matters that may be relevant in determining whether there has been a contravention of s12CB(1) include:*

- *was the payday lender aware that the borrowers were financially distressed and were unable to obtain finance from alternative sources;*
- *was the payday lender aware that the borrowers were unemployed and in receipt of Centrelink payments;*
- *was the borrower required to comply with conditions that were not reasonably necessary to protect the legitimate interests of the payday lender;*
- *was the payday lender aware that the borrowers were not sophisticated in financial affairs and were not able to understand any documents relating to the loan;*
- *did the payday lender charge an excessive amount for the loan having regard to the charges of other payday lenders for equivalent loans;*

- *similar transactions with other borrowers; and*
- *did the payday lender exert undue influence or pressure or have recourse to unfair tactics against the borrower?*"

An important invitation

To date - the political process has talked to lenders.

To date - the political process has talked to consumer advocates.

To date - the political process has not sought to find out exactly how the lending sector works, by observing at the coal face.

But - most distressing of all - to date, the political process has not talked to consumers.

These are not the tiny minority of consumers who approach the consumer advocates either for help with problem debt, or to try to get out of their loan - as default rates will attest - these are the 97% of consumers who get through and successfully use small amount, short term loans to improve their financial situation, or add benefit to their lifestyle choice.

The Delegation invites the Committee and its staff to visit a range of the Delegation's lenders. We will be pleased to provide the Committee with addresses and we will encourage visits without notice, so that the Committee can observe exactly what happens every day and talk to consumers as they come in the door, or make their telephone call.

This is an invitation that has been repeatedly presented to the consumer advocates and to every Minister, in every state introducing relevant legislation, over the last 11 years. Only the Victorians, in 2006, accepted such an invitation.

CONCLUSION

The Delegation would like to thank the Committee Members and the Committee Staff for their consideration of this Submission and sincerely hopes that the Committee's deliberations will result in recommendations to amend the current Bill, by adopting the Delegations' recommendations.

These changes recognise the realities of:

- the needs of the 750,000 Australian consumers who currently rely on the commercial provision of small amount, short term loans; and
- the cost realities faced by the lenders.

Such overriding the un-researched, unrealistic, totally impractical and philosophically driven wishes of the consumer advocates.

Realism must have a higher priority than idealism in these circumstances:

1. As this Submission reveals, there are serious flaws in the proposed legislation that will be the source of administrative problems, which will create continuing consumer political complaint.
2. With the effective abolition of the small amount, short term lending sector and with no satisfactory alternative currently available, Treasurer Wayne Swan will have to find another $3.2 billion for unexpected expenditure in the 2012 and 2013 budgets. Expenditure on non-commercial lending infrastructure will have to commence within months and be completed, with 2,500 full time equivalent staff having been recruited, trained and deployed in readiness for the 4th quarter of 2012, when a substantial number of microlenders will commence exiting the industry sector.
3. Without that funding and the associated staff recruitment and training and establishment of the necessary infrastructure, the Ministers responsible for Centrelink, welfare and liaising with charities, will be inundated with urgent, insistent and substantial demands for help. The same challenge will face Treasurer Swan, if the Government's decision is to establish a permanent loss making Australia Post People's Bank.
4. Without an effective alternative in place to satisfy the 99% of consumer demand currently being catered for by the commercial microlenders, the Minister will face a political

nightmare. This will erupt in Labor's electorate heartland, for reasons that have never been researched by government departments or consumer advocates.

5. If the current Bill is adopted without at least the additions recommended in this submission, the consumer advocates will finally and very quickly learn that their long held, unfounded policies have totally failed.
6. At least 2,500 full time equivalent former lenders, brokers (credit assistance provider), authorised credit representatives and their staff (some 4,000 individuals) will be out of work at a time when the Government is facing increasing pressure to shore up employment.
7. The number of satisfied consumer advocates and even the number of out of work microlending sector people, pales into insignificance in comparison to the negative effect it will have on the ¾ million Australians who currently borrow from microlenders each year.

The Delegation appreciates that the Committee's task is to ensure the legislation reflects reality for both segments of the small amount, short term borrowing population - the *"desperate and vulnerable"* minority and the 80% of people who make up the rest.

We wish to acknowledge the Chair, Deputy Chair and Members of the Committee who make such a constructive contribution to the Senate and legislative process.

Equally importantly, we thank the Committee Secretary and staff who have been unfailingly courteous, professional and helpful whenever members of the Smiles Turner team have had need to contact them during the inquiry period.

The Delegation hopes that this Submission has been of assistance to the Committee in this task and thanks the Committee members and their staff for their consideration of its content.

Phillip Smiles and Lyn Turner

Acknowledgements

The Delegation wishes to thank:

Haydn Cooper, Director, Min-It Software and project liaison director for the Financiers' Association of Australia (FAA) for his 24/7 assistance and his colleagues Debra Cooper and Rod Scott for their forbearance.

John Lynas, Smiles Turner associate, for his research assistance.

The 7 Delegation Committee members who participated in face to face and telephone conference meetings with Treasury, four of whom attended before the Joint Committee on Corporations and Financial Services as witnesses.

The President and Board members of the FAA for their unfailing support.

The Delegation supporters who assisted with editing, including members of the Committee.

The general body of Delegation Supporters, including FAA members, NFSF members and non-members, who bring an industry-wide perspective to this Submission.

The 147 companies representing at least 280 lending outlets, 15 internet services, with over 60 Credit Assistance Providers (brokers) and 180 Authorised Credit Representatives, who directly and indirectly responded to the research surveys over the years.

Most importantly, acknowledgement is due to the over 6,000 consumers who, over the years, have generously made their time available to complete a questionnaire in response to a survey request, or responded to questions during consumer interview programs to assist with general industry analysis and client regulatory compliance.

APPENDIX 1

Smiles Turner Research

This Submission lists findings from a number of research programs concerning the microlending sector, which have been conducted by Smiles Turner, Management, Compliance and Communications Consultants, over the last decade.

In the body of the Submission, for the sake of brevity, they are referred to in an abbreviated manner.

These are:

- 2001 survey, metropolitan Sydney, NSW, with 203 consumer respondents.
- 2003-4, in-depth survey carried out amongst 10 Victorian microlenders.
- November 2006 to February 2007, national research that included 2,044 consumers from NSW, 535 from South Australia (involving 22 outlets), 465 from Queensland and 374 consumers from Western Australia, in a series of 4 studies, using near identical questionnaires (3,418 consumers in total).
- March/April 2007- Privacy Issues Survey, Australian Law Reform Commission Inquiry - 38 lending companies, involving 460 outlets.
- April 2007 - Supplementary consumer survey, South Australia, 412 respondents.
- August 2010 - consumer survey - 303 respondents.
- November 2010 - National Consumer Snapshot, responding to November Treasury Discussion Paper, 441 consumers - all states and territories.
- November 2010 - National lenders' survey, 19 companies, including 6 internet/telephone lenders, 206 outlets and offices.
- March/April 2011 - A case study examining break even and reasonable profit expectations, 9 various lenders. The results of this case study are presented as indicative, not prescriptive, of the whole industry.
- April 2011 - National Consumer Survey, responding to March and April Treasury Discussion Papers, 1,305 consumer respondents.
- April 2011 - National Lender/Broker Survey, responding to March and April Treasury Discussion Papers, 39 Lender/Broker respondents, representing 84 lending outlets.
- May 2011 - National Supplementary Lender Survey, responding to currently discussed issues, 54 Lender respondents, representing 181 lending outlets.
- May 2011 - Supplementary Industry research, 27 selected respondents, over 100 lending outlets including retail, telephone and internet lenders. Questions in response to contact with and contents of Treasury Discussion Paper.
- September 2011 - Delegation Lender Supporter's Questionnaire regarding company profiles and the provisions included in the Exposure Draft Bill, the National Consumer Credit Protection (Enhancements) Bill 2011. Total respondents: 19 companies (49 outlets), representing small, medium and large lenders operating across Australia.
- October 2011 - Industry Research Panel survey regarding issues before the Joint Parliamentary Committee for Corporations and Financial Services, with 27 (106 outlets) respondents, being a representative sample of small, medium and relatively large lenders operating across Australia, being sent a series of questions over a one week period.

The Smiles Turner team is trained at tertiary post-graduate level and highly experienced in undertaking research. The consumer sample sizes statistically reflect what is required for a high level of confidence (considerably within + or - 5%). The bulk of the consumer surveys were self-administered, without the respondent having to identify themselves, with a relatively small component of the last consumer survey involving telephone interviews on the part of a telephone lender.

Smiles Turner and their clients will remain forever grateful to the approximately 5,000 consumers who kindly gave up their time to assist in the various consumer research programs. During all survey periods, it was rare for any lender or broker to report a less than 95% participation rate by the consumers approached to assist as survey respondents.

Consumers have never been paid a fee for their assistance with any of the research programs.

In regard to the Lender/Broker surveys, Smiles Turner deliberately approached a considerable range of lenders and brokers, so that the entirety of the payday and microlending sector would represented, with a reasonable cross-section of respondents.

Respondent numbers and types are regarded as satisfactorily representing every element of the payday and microlending sector and a confidence interval of + or - 10% is suggested. Please note that, in regard to the two largest lending companies, the franchise group City Finance did not participate in Smiles Turner's 2010 and 2011 research programs.

No Contradiction

Over the last 11 years, Smiles Turner has conducted numerous research programs, first for the Australian Financial Services Association in the early years of 2000, then for the National Financial Services Federation until and including November 2010 and since for the Financiers' Association of Australia/Industry/Smiles Turner Delegation. It was expected that they would face close scrutiny, comparative analyses and major research programs from other non-industry interests. However, given that the consumer advocates have not attempted any quantitative research since 2008 and no qualitative research since 2009 - nearly 2 years before the start of the current Commonwealth regime - and that no research at all has been undertaken by Treasury, these industry representations and research results, over the last two years, remain without contradiction.

Appendix 2 **Income generation under the 10%, 2% and 48% 2-tier regime**

Principal	Term (weeks)	Monthly Fee Integer	Mort-gage	10% Fee	Total Monthly Fee(s)	Interest (see Note)	Revenue	Total Payable	Diff in revenue	% Diff Secured/ Unsec'd
100	1	1	N	10.00	2.00	0.00	12.00	112.00		
100	2	1	N	10.00	2.00	0.00	12.00	112.00		
100	4	1	N	10.00	2.00	0.00	12.00	112.00		
250	2	1	N	25.00	5.00	0.00	30.00	280.00		
250	4	1	N	25.00	5.00	0.00	30.00	280.00		
250	6	1	N	25.00	5.00	0.00	30.00	280.00		
250	8	2	N	25.00	10.00	0.00	35.00	285.00		
300	2	1	N	30.00	6.00	0.00	36.00	336.00		
300	4	1	N	30.00	6.00	0.00	36.00	336.00		
300	6	1	N	30.00	6.00	0.00	36.00	336.00		
300	8	2	N	30.00	12.00	0.00	42.00	342.00		
350	2	1	N	35.00	7.00	0.00	42.00	392.00		
350	4	1	N	35.00	7.00	0.00	42.00	392.00		
350	6	1	N	35.00	7.00	0.00	42.00	392.00		
350	8	2	N	35.00	14.00	0.00	49.00	399.00		
350	10	2	N	35.00	14.00	0.00	49.00	399.00		
500	4	1	N	50.00	10.00	0.00	60.00	560.00		
500	8	2	N	50.00	20.00	0.00	70.00	570.00		
500	12	3	N	50.00	30.00	0.00	80.00	580.00		
500	26	6	N	50.00	60.00	0.00	110.00	610.00		
500	26		Y	0.00	0.00	63.31	63.31	563.31	-46.69	42.45%
500	52	12	N	50.00	120.00	0.00	170.00	670.00		
500	52		Y	0.00	0.00	128.79	128.79	628.79	-41.21	24.24%
750	26	6	N	75.00	90.00	0.00	165.00	915.00		
750	26		Y	0.00	0.00	95.07	95.07	845.07	-69.93	42.38%
750	40	9	N	75.00	135.00	0.00	210.00	960.00		
750	40		Y	0.00	0.00	147.22	147.22	897.22	-62.78	29.90%
750	52	12	N	75.00	180.00	0.00	255.00	1005.00		
750	52		Y	0.00	0.00	193.43	193.43	943.43	-61.57	24.15%
750	78	18	N	75.00	270.00	0.00	345.00	1095.00		
750	78		Y	0.00	0.00	298.28	298.28	1048.28	-46.72	13.54%
750	104	24	N	75.00	360.00	0.00	435.00	1185.00		
750	104		Y	0.00	0.00	409.85	409.85	1159.85	-25.15	5.78%
1000	26	6	N	100.00	120.00	0.00	220.00	1220.00		

1000	26		Y	0.00	0.00	126.8	126.80	1126.80	-93.20	42.36%
1000	40	9	N	100.00	180.00	0.00	280.00	1280.00		
1000	40		Y	0.00	0.00	196.36	196.36	1196.36	-83.64	29.87%
1000	52	12	N	100.00	240.00	0.00	340.00	1340.00		
1000	52		Y	0.00	0.00	258.09	258.09	1258.09	-81.91	24.09%
1000	78	18	N	100.00	360.00	0.00	460.00	1460.00		
1000	78		Y	0.00	0.00	398.27	398.27	1398.27	-61.73	13.42%
1000	104	24	N	100.00	480.00	0.00	580.00	1580.00		
1000	104		Y	0.00	0.00	547.03	547.03	1547.03	-32.97	5.68%
1500	40	9	N	150.00	270.00	0.00	420.00	1920.00		
1500	40		Y	0.00	0.00	294.64	294.64	1794.64	-125.36	29.85%
1500	52	12	N	150.00	360.00	0.00	510.00	2010.00		
1500	52		Y	0.00	0.00	387.24	387.24	1887.24	-122.76	24.07%
1500	78	18	N	150.00	540.00	0.00	690.00	2190.00		
1500	78		Y	0.00	0.00	597.69	597.69	2097.69	-92.31	13.38%
1500	104	24	N	150.00	720.00	0.00	870.00	2370.00		
1500	104		Y	0.00	0.00	820.84	820.84	2320.84	-49.16	5.65%
2000	52	12	N	200.00	480.00	0.00	680.00	2680.00		
2000	52		Y	0.00	0.00	516.51	516.51	2516.51	-163.49	24.04%
2000	78	18	N	200.00	720.00	0.00	920.00	2920.00		
2000	78		Y	0.00	0.00	797.19	797.19	2797.19	-122.81	13.35%
2000	104	24	N	200.00	960.00	0.00	1160.00	3160.00		
2000	104		Y	0.00	0.00	1095.44	1095.44	3095.44	-64.56	5.57%
2500	52	0	N	0.00	0.00	645.76	645.76	3145.76		
2500	52		Y	0.00	0.00	645.76	645.76	3145.76		0
2500	78	0	N	0.00	0.00	996.68	996.68	3496.68		
2500	78		Y	0.00	0.00	996.68	996.68	3496.68		0
2500	104	0	N	0.00	0.00	1369.36	1369.36	3869.36		
2500	104		Y	0.00	0.00	1369.36	1369.36	3869.36		0
3000	52	0	N	0.00	0.00	774.94	774.94	3774.94		
3000	52		Y	0.00	0.00	774.94	774.94	3774.94		0
3000	78	0	N	0.00	0.00	1196.20	1196.20	4196.20		
3000	78		Y	0.00	0.00	1196.2	1196.20	4196.20		0
3000	104	0	N	0.00	0.00	1643.87	1643.87	4643.87		
3000	104		Y	0.00	0.00	1643.87	1643.87	4643.87		0

Notes:

1. All calculations made as at 1 July 2011, based on a first repayment date of 8.7.11 and all repayments are weekly.
2. If the establishment fee/monthly administration fee rates are changed from 10%, 2%, the distortion is greater for loans exceeding $2,000.

Appendix 3

90 Day Potential Consumer Assessment

Provided to the Committee as a confidential document, which has been in use since 1 July 2010.

In contrast to Consumer Advocate’s claims of assessment inadequacy, content includes:

- 30 questions re. identification,
- 169 questions re. loan suitability (including purpose),
- 34 questions re. contract specification,
- 64 questions/fields re. assessment guide and
- 4 questions - other.

APPENDIX 4

Break even and reasonable profit - a case study

Break Even Lenders' Figures

These income figures are provided to assist in assessing the economic unreality of a 48% cap, when the break even calculations of lenders are compared with the Delegation's selection of a diverse group of lenders to participate in a 'break even' and 'reasonable profits' analysis in May 2011.

Below is the data provided by 9 lenders, regarding their assessment of break even (BE) and a reasonable profit (RP) on varying loan amounts, for the terms as indicated in the second column.

The following table presents the companies' calculations. In part, the companies were selected to demonstrate the impact of location on costs. For example, one regional centre's wages, per hour, were 77% of that paid by a metropolitan firm.

BE = Break Even; RP = Reasonable Profit; NO = Not Offered; Amt = Amount.

Loan Amt.	Term (weeks)	Co.1 - Gross amt		Co.2 - Gross amt		Co.3 - Gross amt		Co.4 - Gross amt		Co.5 - Gross amt		Co.6 - Gross amt		Co.7 - Gross amt		Co.8 - Gross amt		Co.9 - Gross amt	
		BE $	RP $	BE $	RP $	BE $	RP $	BE $	RP $	BE $	RP $	BE $	RP $	BE $	RP $	BE $	RP $	BE $	RP $
$500	26	380	560	356	409	350	500	NO	NO	233	288	101	154	316	442	250	350	150	245
$750	40	450	680	434	543	400	500	NO	NO	301	376	204	326	387	506	450	550	200	400
$1,000	52	600	800	644	805	450	500	500	700	578	696	365	547	444	570	750	850	390	750
$1,500	52	650	850	836	1,045	NO	NO	NO	NO	773	999	392	626	635	698	1250	1250	500	900
$2,000	52	750	900	920	1,150	NO	NO	NO	NO	1,031	1,282	488	754	826	1,014	1,650	1,750	630	1200
$2,500	76	850	1,050	NO	NO	NO	NO	NO	NO	1,288	1,604	562	883	1,332	1,472	2,800	2,900	950	1700
$3,000	104	1,000	1,250	NO	NO	NO	NO	NO	NO	3,199	3,978	744	1,104	1,799	1,954	4,600	4,700	1,400	2,418

Appendix 5

Econometric Modelling methodology

The modelling is predicated on the application of a 'cost-up' methodology for a typical microlending industry participant (at steady state) and, by incorporating the appropriate market return, it is possible to determine the average minimum unit price that must be obtained for a typical product, for the typical microlending provider to remain financially viable and not be forced to exit the industry. The revenue per unit cost has been broken into two revenue components:

1. Revenue based on current interest rate cap of 48%; and
2. Total other revenue for ascertainable fees and charges that must be obtained for a typical microlending industry participant to remain viable. This fee is considered, to encapsulate the services of loan procurement (marketing), loan assessment and contract establishment, compliance costs and loan administration and service charges, for the term of the loan.

Costs have been included, based on one lender's current experience, a panel of lenders providing costs comment and the application of general business ratios for industry non-specific costs.

Industry diversity

Given the microlending sector's diversity, it is challenging and problematic to endeavour to typify a business model that adequately represents the broad spectrum of industry participants. However, such a definition is required, if the Delegation is to attempt to determine a product unit cost that serves to identify an average revenue figure, which may be indicative of the figure required to retain industry viability. This can be considered an approximation for the 'marginal point' of average industry viability and will not provide sufficient return to ensure viability of all current microlenders.

Furthermore, as cost increases must be borne by the microlender, should prices be fixed, then inflationary pressures of any kind (including increasing compliance costs as the NCCP continues to gestate), will worsen the 'marginal point' and drive more microlenders out of the industry. To summarise, the supply side diminishes while demand continues unabated.

Model limitations

It is recognised that there are a number of key risks involved with any price-fixing legislation. Three of particular concern, to the microlending sector, are listed below:

1. Pricing of financial markets must be commensurate with risk (as defined by volatility of return). Microlending is considerably riskier than conventional banking and studies have shown risk levels are more aligned to the financial risk inherent in private equity funding, with returns of 25-30% necessary to justify capital investment risk. Capping prices below the requisite risk pricing point will destroy the balance of supply necessary to sustain the industry.
2. New entrants to the market could be negligible, given profit potential is artificially constrained and the time to develop a profitable loan book is increased.
3. A natural gravitation toward lower amounts of credit being provided and reduced diversity of product and service offerings. If an interest rate cap does not provided sufficient return on capital, there exists a financially compelling incentive to lend lower amounts of capital, to optimise profitability (refer modelling scenarios for varying loan quantum), for lesser periods of time.

The modelling is provided to the Committee as a confidential document and include:

1. The expected industry based case.
2. The expected industry based case, indicating substantially conservative costs (halved).
3. Model without proprietor's/owner's salary.
4. Model with reduced marketing and legal expenses, appropriate for a mature business.

Appendix 6

ABOUT OUR CONSUMERS

The April 2011 Smiles Turner National Consumer Survey, involving 1,305 respondents, provided the following Consumer Profile. Questions were presented in March/April requesting information for the calendar year 2010. Where there is an opportunity for comparison, the information obtained from the late November 2010 survey, where consumers were asked for information relevant to the preceding 12 months, is included.

Sex of consumers

Females - 55.14%

Males - 44.86%

Age range

18-24	12.38%
25-34	25.54%
35.44	26.67%
45-54	19.35%
55-64	11.59%
65 and over	4.44%

Highest level of formal education

Years 9,10,11	36.73%
HSC	21.99%
TAFE	17.92%
University	11.47%
Other	10.27%

Household structure

Single adult	37.36%
2 adults	38.76%
3-10 adults	23.86%
No. of people under 18 living in household	Nil - 51.83%
1 under 18	17.75%
2 Under 18	18.69%
3 or more	11.71%

Employment status

Employed	67.31%
Employed full time	53.24%
Centrelink	48.73%
Weekly income $1-$500	24.61%
Weekly income $501-$999	53.46%
Weekly income $1,000 +	21.92%

Employed - hours worked

1-9 hours	3.2%
10-19	7.56%
20-29	10.13%
30-39	51.66%
40-49	20.26%
50 +	7.18%

Number of rollovers used, 2010

Nil	24.98%
1 rollover	13.56%
2 rollovers	5.06%
3 rollovers	1.61%
4 rollovers	1.23%
5 rollovers	0.61%
6 rollovers	0.54%
7 rollovers	0.23%
8 rollovers	0.23%
9 rollovers	Nil
10 rollovers	0.31%
More than 10 rollovers	0.23%

The number of November 2010 respondents who had rolled over at least 1 loan in the previous 12 months was 42.52%.

Another loan taken out with a different lender, to repay the previous loan

1 loan	7.81%
2 loans	3.3%
3 loans	1.07%
4 loans	0.46%
5 loans	0.92%
6 loans	0.08%
8 loans	0.23%
10 loans	0.23%
8 rollovers	0.23%
12 or more	0.38%

Number of loans taken out, 2010

Nil	26.87%
1 loan	23.33%
2 loans	24.56%
3 loans	8.07%
4 loans	4.69%
5 loans	2.86%
6 loans	1.97%
7 loans	0.57%
8 loans	1.56%
9 loans	0.24%
10 loans	2.22%
11-19 loans	1.38%
20 or more	1.55%

No statistics were collected in regard to the length of these loans. Any consideration of the larger numbers of loans borrowed by some consumers, must take into account that there are lenders who specialise in small amount loans for a fortnight or less.

The number of loans taken out in the preceding 12 months, by respondents to the November 2010 survey was 2.665.

Non-payday/microlending experience

2010 Survey respondents, who had previously applied for a bank, building society or credit union loan - 52.3%. Success rate, 56.9% of those applicants.

Number of November 2010 respondents who had ever had a credit card - 42.9%. Number with a credit card at time of survey - 21.85%.

In 2010, 5.8% borrowed from a bank, building society or credit union at least once.

In 2010, 42.8% drew cash out on a credit card at least once.

Anytime in the past, 14.9% had sought help from a charity and 25% had sought concessions for utility bills.

Previous payday/microlender experience

Anytime in the past - 71% had borrowed at least once from at least one other payday/microlender.

Reasons for borrowing (aggregated, 2010 survey)

Distress/emergency purposes	17.2%
Unexpected bills	26.7%
Expected bills	26.9%
Discretionary spending	25.2%
Gambling	0.3%

Credit cards

In 2010, while approximately 6-10% of consumers had used a store card, hire purchase, lease, rental or "interest free" deal, the largest other sources of credit were credit cards, Centrelink advance payments and periodic utility payment arrangements.

47.81% had previously used a credit card and 25.44% of total respondents had used their card in the preceding 12 months.

Number of credit cards per person	% of total respondents	% of credit card holders
1 card	19%	66.3%
2 cards	7.43%	25.94%
3 cards	0.84%	2.94%
4 cards	0.08%	0.27%
5 cards	0.15%	0.53%

Overall financial circumstances (over previous 12 months)

At least 1 Centrelink advance payment	24.82%
Utility periodic payment	15.7%
In financial trouble once, left unable to meet loan repayments	26.05%
Trouble paying bills on time	7.73%
Generally able to pay bills	90.27%
Made a hardship application	1.52%

During the period, 76.9% of lenders lent to Centrelink benefit recipients.

On average, 24.5% of borrowers were on Centrelink for the whole of their income (highest 37.5%) and 26.7% of their customers received income that partly contained a Centrelink benefit.

35.9% of lenders lent to people involved with utility hardship programs. However, 67% of those lenders did not have any consumers that were in that position at the time of the survey.

In regard to the remainder prepared to lend to utility hardship program beneficiaries, the proportion of their customers involved varied from 1% to 30%.

Aggregated - reasons for borrowing

Consumer advocates have approved of borrowing for emergencies but, in their campaign to reduce the availability of small amount, short term loans, fail to recognise those loans taken because the, often, non-financial cost is far greater than the interest, fees and charges paid, e.g. buying a child's birthday present. The importance of functional borrowing, e.g. to repair a car, new tyres for a boat trailer, etc. is also ignored, as is the importance of a new outfit to attend a wedding, or money to pay for a pet's operation, etc. to someone who borrows for a lifestyle need.

It is noted that any claims of gambling being a consistent reason for small amount, short term borrowing are not factually based.

Emergencies	11.34%
Potential or possible emergencies	13.18%
Psychological purchase need	6.59%
Associated with accommodation	3.45%
Lifestyle	7.12%
Functional expenditure	12.18%
Gambling	0.076%
Other	46.14%

Total number of people borrowing in 2010 - 750,000.

Total number of loans - at least 1.5 million.

Where will they go if their current lender is closed down?

Nowhere to go	70.49%
Extension of bill payment	2.23%
Government assistance	1%
Centrelink	0.9%
Pawn broker	0.5%
Charity	0.3%
Other optimistic assessments:	
Bank, building society, credit union, finance companies	11.5%
Friends and family	7.7%
Another lender	1.7%
Other (incl. crime, prostitution, illegal lenders)	3.68%

Over the last decade, Smiles Turner research has measured between a low of 65.5% and a high of 81.6%, the number of respondents who indicated they had nowhere else to go, with an average 70.57%.

Defaults

93.46% of loans went full term, with the lender being full repaid.

In regard to the defaulting loans, the following track record was revealed:

No. of defaults	% of respondents	% defaults repaired	Successful hardship appl.	Balance un-repaired
1	29.7%	65.5%	1.2%	10.05%
2	20.5%	69.6%	1.6%	4.65%
3	12.3%	47.9%	4.7%	1.19%

It is the far right hand column that contributed to the lenders' bad debts.