



Promoting Responsible Consumer Lending

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Submission to

Senate Economics Legislation Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

Re the
Consumer Credit And Corporations Legislation Amendment (Enhancements) Bill 2011

Submitted via email to
economics.sen@aph.gov.au

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NATIONAL FINANCIAL SERVICES FEDERATION

The National Financial Services Federation (the Federation) represents almost 300 ASIC-licensed, small-amount, short-term credit providers who arrange more than \$800 million of loans to over 500,000 consumers each year. The Federation has a diverse membership that offers lending products ranging from payday loans to personal term loans. The amounts lent range from \$50 to \$10,000, for terms from a number of weeks to several years. Some members provide just the one type of loan, some provide a range of loan services.

The Federation has been closely involved in a Government consultation process since the then Minister Nick Sherry announced in July 2008 that the Commonwealth intended to take over regulation of credit from the States. The Federation has since appeared before the Senate Economics Committee in August 2009 and has been in regular consultation with Treasury.

We welcome the opportunity to submit comments to the Senate Economics Legislation Committee on the Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011 (the Bill).

The Federation strongly supports regulation that:

- Protects vulnerable and disadvantaged Australians from financial over-commitment
- Ensures consumers have access to the provision of responsibly provided credit services , are fully aware of the alternatives and clearly understand loan costs
- Provides a sustainable commercial environment for the industry
- Discourages illegal loan providers

The Federation has supported major regulatory changes (see Appendix 1) under the National Consumer Credit Protection Act, which took effect from 1 July 2010, accepting that these changes have added significant costs to the provision of small amount short term credit.

However, the Bill diverges significantly from the recent course of regulation and will have significant unintended consequences for consumers and the ASIC-licensed industry.

We have, therefore, proposed a compromise solution that improves consumer protection while retaining a viable industry and averting financial exclusion for many Australians.

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Flawed Legislation Will Hurt Consumers

Significant components of the Government's proposed Amendments are unworkable and impractical and will make the commercial environment for the Federation's members unviable.

Specifically:

Consumers will lose financial flexibility should their circumstances change (Schedule 3). A borrower who has an existing Small Amount Credit Contract won't be able to: increase the loan limit; refinance the loan with the existing lender or another lender; or take out another loan running concurrently with the existing loan – even if they could afford to.

The amendments are at odds with the principle of Responsible Lending introduced in Phase 1: that a loan needs to be affordable and fit for the purpose. That is, the right loan, right amount, right term, and right purpose. If a consumer needs \$X for Y days, then it should be obtainable.

Proposed Price controls (Schedule 4) are set below the cost of supply of small amount short term loans and are an unworkable cap on larger loans.

Most market participants will close their doors while a few others may be able to turn to other commercially viable areas of the finance sector.

The end result will be that more than 500,000 consumers that currently use this form of short-term finance will be financial excluded from an important source of funds and will be left with less optimal means of making ends meet. (Appendix 8 – Users of Small Amount Contracts).

The Government, in turn, would face calls for a significant boost in funding to community and consumer assistance groups to meet a sudden increase in demand from consumers facing financial exclusion from short-term credit.

The cost of enforcing these amendments would also be significant as unlicensed and illegal lenders would be able to flourish in the absence of licensed, highly-regulated lenders.

It is important to note that Australia's major banks, which exited the small amount, short-term loan sector in the 1990s, have been silent so far and have given no indication that they are willing to re-enter the market aside from providing limited funding to not-for-profit community groups.

Australian Academic Research - Price Caps Don't Work

Research by respected academics in Australia has found that price controls won't work.

Professor Stephen Corones¹ at the Queensland University of Technology in "Phase Two of the National Credit Reforms Examining the Regulation of Payday Lenders" (March 2011) <http://www.ljrc.law.qut.edu.au/files/PhaseIICreditReforms-regulationofPaydayLending.pdf> found that there is no compelling argument for further specific protection measures:

- "While interest rates caps have been heralded as the only regulatory measure that can adequately protect vulnerable consumers, the evidence of recent studies appears to indicate the contrary. (p 55 – Summary and conclusions)
- "If lenders withdraw from the market, this form of credit will not be available to any borrowers, including those who might have been able to afford the loan. Withdrawal or severe restriction is likely to produce financial exclusion or channel the most vulnerable borrowers to illegal lenders. (p 55 – Summary and conclusions)
- "The more preferable regulatory response appears to lie in the adoption of the responsible lending regulations, together with the associated licensing, conduct and disclosure obligations, to prevent credit being extended to those who cannot afford to repay it. (p 55 – Summary and conclusions)
- **"In conclusion there appears to be no evidence that the general protections in the NCCP and the ASIC Act and the remedies they make available to payday borrowers are inadequate. On the contrary, we believe they are comprehensive and sufficient.** (p 56 – Summary and conclusions)

International Regulatory Research - Price Caps Don't Work

Studies by the U.S. Federal Reserve and the U.K. Office of Fair Trading have found that a ban on payday loans meant households ended up paying more default fees and charges on other forms of finance and were forced into the hands of loan sharks:

Federal Reserve Bank of New York in "Payday Holiday: How Households Fare after Payday Credit Bans" (Nov 2007) http://www.newyorkfed.org/research/staff_reports/sr309.html

- **Households in Georgia and North Carolina, where payday loans were banned, were worse off.** There were more bounced cheques, more complaints about lenders and debt collectors and more bankruptcies.

¹ Professor Stephen Corones, B.Com (Qld) LLB (Qld) LLM (Lond) PhD (Qld) Professor of Law, Queensland University of Technology, Listed as one of Australia's leading competition lawyers in the 'Best Lawyers' 2010 report published by the Australian Financial Review.
2005-2009: Deputy Chair of the Trade Practices Committee of the Law Council of Australia. 2008: Appointed by the Minister for Competition Policy and Consumer Affairs to the Commonwealth Consumer Affairs Advisory Council (CCAAC) for a three year term, 2007: Engaged by the Productivity Commission to prepare a Comparative Study of State and Commonwealth Consumer Protection and to provide related advice.

The UK Office of Fair Trading in "Review of High Cost Credit" (June 2010)

http://www.oft.gov.uk/shared_oftr/reports/consumer_credit/High-cost-credit-review/OFT1232.pdf

- **Unviable price controls would force legitimate lenders out of business and send consumers into the hands of loan sharks.** Moreover, price controls are expensive and difficult to enforce.

Treasury's Regulation Impact Study

The Government's proposed Amendments are at odds with Treasury's own Regulation Impact Study.

Treasury acknowledged in the RIS that a price "*cap can be set too low, and therefore risks putting out of business large parts of the market*" (as has been argued in relation to the current cap in New South Wales of 48%).

The RIS said that a cap for short-term loans should be consistent with the costs of providing such loans and used the example of \$30 in charges for every \$100 short-term loan.

The RIS also considered the effect of a tiered approach to costs on short-term credit providers and lessors and found that "*if it is too low, it may restrict the availability of short-term credit by limiting charges to such an extent that short-term lending businesses become unprofitable. The consequences of this could be either greater exclusion from the credit market of certain sections of the Australian population, or the emergence of an unregulated market in short term credit.*"

New Amendments Diverge Sharply From Regulatory Course

Minister Bill Shorten and many who support this legislative review have made it clear that a viable industry is important to the credit sector as a whole and to consumers who want to have the choice of accessing a commercially provided small amount, short-term loan.

The Federation is particularly concerned that the latest amendments diverge significantly from the recent course of regulatory change in the industry and, in fact, mean that the industry will become unviable.

Up until the Bill was made public, regulatory discussions had focused on improved, government-funded solutions, programs to improve financial education and maintenance of a viable industry. **The Federation fully supports these ongoing discussions and recommends that a short-term loan industry forum, similar to that which operates in the United Kingdom, is established.** This forum would provide a meaningful opportunity for all participants from industry, government, and the consumer advocacy sector to review lending

practices and general industry standards while ensuring that consumer protection remains of the highest standards.

New Amendments Make Phase 1 Changes Irrelevant

Credit providers have spent significant sums of money - tens of thousands of dollars, and in some cases hundreds of thousands of dollars - prior to 1 July, 2010 to gain a credit license and to comply with other regulatory changes. These licenses will become worthless under the new Amendments.

Importantly, the significant regulatory changes in Phase 1 have not had time to become bedded down before the Government is embarking on another major series of changes.

Again, what concerns the Federation is that when licensing was introduced, there was no indication given by Treasury or the Government of the severe restrictive and unviable content of the proposed Amendments.

There are over 2000² ASIC-registered credit license holders who will be affected. **Combined, these credit providers employ several thousand full time staff across Australia who will no longer have employment or livelihood prospects if this new legislation takes effect.**

Cases of consumer detriment are extremely low

Cases of consumer detriment have occurred in the small amount short term lending sector, just as they occur in all other credit sectors and all other industry sectors. However the number of cases is low given the million-plus transactions each year that occur in our industry sector and do not mean there has been a market failure.

We understand that 100 per cent of a consumer advocate's day is like a vehicle smash repairer or doctor in the emergency ward; they only see the consumers when something goes wrong, they don't see the remainder of the population who never need their assistance.

In a report by the Credit Ombudsman, it was reported that there were 60 resolvable complaints in the first end of operation, ending 30 June, 2011 – which are estimated by the Federation to represent an industry wide complaint rate of 0.005 of one per cent when compared to the estimated number of transactions per year.

² ASIC Media Release 147, notes that for micro Loans (less than \$3000) there are 1089 licensees & for short-term loans (not more than 6 months) there are 2147 Licensees as of 21st July 2011. Ref <http://www.asic.gov.au/asic/asic.nsf/byHeadline/11%E2%80%9393147MR%20ASIC%20successfully%20completes%20credit%20licensing?opendocument>

Compromise Proposal – A Solution That Works For Everyone

The Federation proposes a practical solution that will improve consumer protection while retaining a viable industry, thus averting financial exclusion for many Australians. (Appendix 2 – Tables detail proposal in full)

Significant resources and time have been spent and research conducted in the development of this proposal with the aim to eliminate any unintended outcomes for consumers, the industry or any other credit sector.

The content of the submission reflects the feedback of our members and the vast knowledge of the Federation's Board, which exceeds 150 years of combined lending experience in a variety of areas including small amount, short-term loans and mainstream banking.

The Federation's proposal includes the introduction of the following:

A Protected Earnings Amount For Borrowers (Appendix 3 – details)

- Consumers could commit only a MAXIMUM of 35% of net pay to repayment of Small Amount Credit Contracts.

Allow Consumers The Right To Rescind Small Amount Contracts

- Consumers would have a "cooling-off period" of one business day during which they could rescind Small Amount Contracts without financial penalty.

Direct Debit Suspension

- Credit providers would have to suspend direct debit payments after three consecutive failed direct debit attempts until the consumer is contacted to prevent a borrower accumulating both lender and bank fees for dishonoured payments.

Debt Spiral Controls Extended To Third Parties

- If a Small Amount Contract is sold or passed to an external debt collection firm or other entity, those third parties would also be bound by the "twice adjusted credit amount" debt spiral control.

Short-Term Credit Forum

- Initiation by Government of a regular forum between the credit industry and consumer groups to exchange ideas and ensure best practice. It could also include the Credit Ombudsman and Government regulators.

Redefine Short-Term Credit Contract

- To reflect both consumer use and to align with ASIC's definition of a short-term loan, we request that the Term of a Small Amount Credit Contract be reduced from 2 years to 6 months, and the value reduced from \$2000 to \$500.

Established a viable cap For Small Amount Credit Contracts (Appendix 4)

- replace 10%/2% cap with 28%/2% cap, which reduces the cost to consumers below the current market average, but allows the commercially viable provision of loans.

Allow Permitted Establishment Fee On Certain Contracts (Other Than Small Amount Contracts)

- A Permitted Establishment Fee plus Daily Reducing Interest capped at 48% would allow credit providers to cover costs.

The benefits of the Federation's proposal

- Meet the objective of reducing the cost to consumers for small amount credit contracts
- Extended and improved protection from over commitment for low-income consumers
- Ensured choice and flexibility for consumers through a viable and competitive business environment
- Consumers not restricted to a single credit provider
- Potential for a change in a consumer's situation during the term of the loan is accounted for regardless of the size and length of the loan
- Greatly reduced need for unworkable prescriptive amendments to be inserted in principals-based legislation

We already agree with the Government on a number of important issues:

- **Protecting low income consumers** by enhancing the National Consumer Credit Protection Act 2009 and greatly improving the availability of services provided by various community groups, such as no-interest and low-interest loan schemes (NILs & LILs). These services have been under funded for many years and require an urgent overhaul. This is the right policy outcome and improvement for this minority group (of low income consumers).
- **Greater flexibility around Centrelink loans to low income consumers**
- **Improved hardship programs within Electricity & Gas suppliers.**

An Important Qualifier

The following recommendations (Appendix 2 Tables)

only work when implemented as an entire package of reform changes.

Any selective implementation will challenge the viability and consumer benefit or make unworkable the other recommendations.

We have not studied or considered the unintended consequences of partial implementation.

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Appendix 1 – Major Reforms Supported By The Federation

The following regulations have been introduced and supported by the Federation and its members as part of the new credit regime under the NCCP ACT:

- Appointment of ASIC as the industry authority body
- Registration and then licensing of all credit providers as ACL holders with ASIC
- Requirement to be member of an approved EDR scheme
- Requirement to have PI insurance
- Requirement to have written compliance plans
- Requirement to have a suitably qualified Responsible Manager in the business
- Compliance with General Conduct Obligations
- Compliance with Responsible Lending Obligations
- Meet financial resource requirements including requirement to have a Financial Manager
- Requirement to have minimum levels of competence and training
- Increased disclosure requirements by credit providers.

Appendix 2 – The Federation Proposal

Our proposal is summarised in two tables, with explanatory notes, history and reasoning for the proposed changes contained on the following pages.

Table 1 New and additional improvements for enhanced consumer protection

Table 2 Amendments to the Bill (as tabled)

Table 1 New and additional improvements for Enhanced Consumer Protection				
Section	Type of change	Description of the Change or Action	Outcome	Comment
New Protected Earnings Amount PRIMARY REFORM OPTION AROUND WHICH ALL OTHER REFORMS ARE ABLE TO BE IMPLEMENTED. (Appendix 3 – full details)	Insert	Introduction of a Protected Earnings Amount for Small Amount Credit Contracts for all consumers	Improved consumer protection	Ensures users of Small Amount Credit contracts cannot over commit themselves. This single enhancement addresses nearly all consumer advocate concerns, meets Government policy objectives and allows the removal of unworkable and impractical sections 32A, 32B, 39A, 124B, 124C, 133CB, 133CC, 133CD.
New Cooling off Period	Insert	Allows consumers to rescind a Small Amount Contract within one business day with no financial penalty.	Improved consumer protection	If the consumer is able to source funds from another source such as family, friend or reconsiders the loan, it gives them a choice to opt out.
New Direct Debit Suspension	Insert	A provision where a credit provider must suspend direct debit payments after three consecutive failed direct debit attempts regardless of loan type until the consumer is contacted.	Improved consumer protection	Reduces the risk of consumers accumulating both lender and bank fees for dishonoured repayments.

Table 1 New and additional improvements for Enhanced Consumer Protection				
Section	Type of change	Description of the Change or Action	Outcome	Comment
NEW 39B <i>Limit on amount that maybe recovered if there is a default [under a small amount credit contract]</i>	Insert 39B(4)	A requirement that if a Small Amount Contract is sold or passed to an external debt collection firm, etc, those subsequent parties are also bound by the 'twice adjusted credit amount' debt spiral control.	Improved consumer protection that prevents Debt Spiral from Third Parties	Protects low income consumers from debt spiralling fees or charges from Third Parties. This is currently a 'hole' in the protection mechanisms for small amount contract users.
NEW Credit Forum		Government to initiate regular round table forums between the credit industry and consumer groups. Could also include the Credit Ombudsman and Government Regulators	Improved consumer protection	All stakeholders that interact with consumers can exchange ideas of best practice. Emerging detrimental market place issues could be identified with prompt pre-emptive action implemented.

Table 2 Amendments to the Bill (as tabled)				
Section	Type of change	Description	Outcome / Action	Suggested change or comment
5(1)(b) <i>Small amount credit contracts: a contract is a small amount credit contract if:</i> <i>(b) the credit provider under the contract is not an ADI;</i>	Remove	Sub section (b)	Provides consumers with protection regardless of the type of credit provider being used.	All Australian Credit Licence holders operate under the same rules. The law must apply equally to all licensed credit providers. Non-bank lenders provide similar, if not the same products, to ADI's. Creates an unfair market place and possible anti-competitive issues.
5(1)(d) <i>the credit limit of the contract is \$2,000 (or such other amount as is prescribed by the regulations) or less;</i>	Replace	\$2000	with	\$500 To reflect actual product usage in the market place
5(1)(e) <i>the term of the contract is 2 years (or such other number of years as is prescribed by the regulations) or less; and</i>	Replace	2 years	with	6 months Brings the loan term into line with ASIC's definition of short-term loans – i.e. up to 6 months.
31A(1)(a) <i>Restrictions on fees and charges for small amount credit contracts</i> <i>(1) A small amount credit contract must not impose or provide for fees and charges if the fees and charges are not of the following kind:</i> <i>(a) a fee or charge (a permitted establishment fee) that reflects the credit provider's reasonable costs of determining the application for credit and the initial administrative costs of providing the credit under the contract;</i>	Replace	<i>a fee or charge (a permitted establishment fee) that reflects the credit provider's reasonable costs of determining the application for credit and the initial administrative costs of providing the credit under the contract</i>	with	<i>a fee or charge (a permitted establishment fee) that reflects the credit provider's reasonable averaged costs of determining the application for credit under the contract.</i> <i>As in any business, the income from approved loans (sale of goods or services) need to subsidise the real and incurred costs for (such as, but not limited to) loan applications which are declined, the management of hardship cases and bad debts.</i>

Table 2 Amendments to the Bill (as tabled)				
Section	Type of change	Description	Outcome / Action	Suggested change or comment
31A(2) <i>Restrictions on fees and charges for small amount credit contracts</i>	Replace	10 per cent	with	28 per cent
32A(1) <i>Prohibitions relating to credit contracts if the annual cost rate exceeds 48%</i> (Appendix 4 – full details)	Remove	Subsection 32A(1)	Substitute with	Permitted Establishment fee PLUS 48% daily reducing interest rate cap.
32A(4)(a) <i>This section does not apply if:</i> (a) <i>The credit provider is an ADI;</i>	Remove	Sub section (a)	Provides consumers with protection regardless of the type of credit provider being used.	All Australian Credit Licence holders operate under the same rules. The law must apply equally to all licensed credit providers. Non-bank lenders provide similar, if not the same products, to ADI's. Creates an unfair market place and possible anti-competitive issues.
32B <i>Calculation of annual cost rate</i>	Remove	Entire Section		No formula is required if Daily Reducing Interest is adopted.
39A <i>Limit on the applications of amount of credit provided under a small amount credit contract</i>	Remove	Entire Section	Policy objectives met by	New Protected Earnings Amount provision.
39B <i>Limit on amount that maybe recovered if there is a default [under a small amount credit contract]</i>	Amend	Remove all references to "small amount credit contract"	Improved consumer protection that prevents Debt Spiral	Apply this debt spiral control mechanism to all consumer personal loans, excluding loans secured by real property (home loans).

Table 2 Amendments to the Bill (as tabled)				
Section	Type of change	Description	Outcome / Action	Suggested change or comment
39B(3) <i>Limit on amount that maybe recovered if there is a default [under a small amount credit contract]</i> <i>(3) This section does not apply to enforce expenses.</i>	Amend	Sub section (3)	Exclude Small Amount Short Credit Contracts	Reduces the ability for a Small Amount Contract to debt spiral with Third Party costs. NOT PRACTICAL IF 5(1)(d) is greater than \$500
124B <i>Prohibition on suggesting, or assisting with, small amount credit contracts</i>	Remove	Entire Section	Replace with	New Protected Earnings Amount provision, which meets the Policy objectives
124C <i>Prohibition on suggesting, or assisting with, credit limit increases</i>	Remove	Entire Section	Replace with	New Protected Earnings Amount provision, which meets the Policy objectives
133CB <i>Credit providers must not enter into small amount credit contracts in certain circumstances</i>	Remove	Entire Section	Replace with	New Protected Earnings Amount provision, which meets the Policy objectives
133CC <i>Credit providers must not refinance credit provided under small amount credit contracts</i>	Remove	Entire Section	Replace with	New Protected Earnings Amount provision, which meets the Policy objectives
133CD <i>Credit providers must not increase the credit limit of small amount credit contracts</i>	Remove	Entire Section	Replace with	New Protected Earnings Amount provision, which meets the Policy objectives
204(1)	Remove	Proposed definition that relates to "annual cost rate" in section 32B		Not required.

Appendix 3 - Protected Earnings Amount

The Federation proposes a new subclause 5(1)(g), *Protected Earnings Amount*, of 65% of net pay (Gross Income less Tax) to apply to Small Amount Credit Contracts.

Rationale

Notwithstanding the NCCP's Responsible Lending obligations, borrower over-commitment is a concern often raised. As a result, the Government's proposed Amendments introduce restrictions on refinancing and multiple loans as preventative measures against over-commitment. However there would be significant unintended consequences and impracticalities of such restrictions. The Federation, therefore, proposes an alternative.

Detail

Our proposal is to, in effect, create a safety net.

A consumer would be able to commit only up to a maximum of 35% of their net pay to the repayment of Small Amount Credit Contracts, thus ensuring funds are preserved for essential day-to-day items. The value in the majority of cases would amount to less than 35% after the credit provider assessed the consumer's current financial commitments.

Benefits

For lower income consumers, it would lengthen the period of the loan repayment over a number of pay periods. This would eliminate the single repayment loans for small amount short term contracts, which have been known to cause hardship.

Lengthening the loan repayment period would:

- **Reduce the likelihood of consumers continually borrowing**
- **Reduce the number of loans a consumer accesses per year**

This simple concept already has **legislative precedence at Federal level** via the Child Support Agency Protected Earnings Amount.³

It does not require the Government to put any income value on low-income consumers.

The consumer retains flexibility to:

- Have a number of Small Amount Credit Contracts where a genuine need exists and Responsible Lending Obligations have been followed, and
- Increase their credit limit, and/or refinance if they wish, provided the combined repayments of any known Small Amount Credit Contract falls within the balance of the Protected Earnings Amount.

The proposals satisfy the Minister's stated objectives to:

³ Child Support Agency PEA http://www.csa.gov.au/employers/what_is_protected_earnings_amount.php

- Avoid financial controls around a class of consumers
- Avoid financial exclusion of consumers from the opportunity to seek credit regardless of their income level or source of income
- Allow the non-bank small amount credit industry to continue to provide small amount, short-term loans.

Example of Protected Earnings Amount using the Max and Min's of all parameters.

Net Weekly Income (\$)	300	500	700	900	1100
Protected Earnings Amount (65% of Net)	195	325	455	585	715
MAXIMUM dollar amount that can be allocated for Small Amount Credit Contract repayments after all Responsible Lending Obligations have been met.	105	175	245	315	385
Short-Term Loans (Based on Net Weekly Income Above)					
	\$350 Loan				
Maximum Repayable*	462	455	455	455	455
Minimum Number of Weekly repayments	5	3	2	2	2
	\$500 Loan				
Maximum Repayable*	660	650	650	650	650
Minimum Number of Weekly repayments	7	4	3	3	2

*section 32A, 28% maximum used as per the Federation's proposal

Appendix 4 - Division 4A – Annual Cost rate of certain contracts

The Federation proposes:

- Remove existing sub section 32A(1) and replace with a Permitted Establishment fee and Daily Reducing Interest capped at 48%, and
- Remove existing section 32B replace with the definition and calculations for Daily Reducing Interest, capped at 48%.

Rationale

The pricing controls for credit contracts other than Small Amount Credit Contracts, must allow the credit provider to recover reasonable costs and make a profit. The Government's proposed section 32B, which effectively adopts the New South Wales interest rate cap formula, does not allow this to occur for short-term loans.

The State of Victoria, the only state to undertake a major research project⁴ into credit, found that imposing the price capping structure as included in section 32B was not required and could have unintended consequences.

The drafting of the Amendments effectively locks out mainstream lenders from ever re-entering this market space due to the restrictive price controls for small amount and short term loans.

The New South Wales Interest Rate Cap

The NSW interest rate cap is basically unworkable for loan contracts under \$4000 and under 1 year.

You will hear from consumer advocates that credit providers already operate in NSW "under this cap" and have done so for several years, so what is wrong with it? That is true if you only want a high-value, long-term loan. On one hand they say the cap works in NSW (and Qld), on the other hand they bring complaints to the Credit Ombudsman Service regarding the cost to the customer due to lender avoidance tactics. The true test is the cost to the borrower is effectively the same across all states, because a lender cannot viably operate under a 48% cap.

If you are one of the nearly 150,000 consumers in NSW who do not want, or cannot, access due to affordability, larger value or longer-term loans, but who prefer to use small amount credit loans under \$3000, then that credit is not supplied under the cap.

For short-term loans, lenders have been forced to:

- Run at a loss and subsidise the loans from other business interests
- Seek legal advice and implement alternative legal models

⁴ 2006 Consumer Credit Review

Appendix 5 – Status Of Interest Rate Caps In Australian States

Current Status of Interest Rate Caps

No cap is the same in any State or Territory

State/Territory	Cap on Interest Rates and/ or fees and charges?
A.C.T.	Yes
New South Wales	Yes
Northern Territory	No
Queensland	Yes
South Australia	No
Tasmania	No
Victoria	Yes
Western Australia	No

Appendix 6 - Annual Percentage Rates (APR)

Annual Percentage Rates are not a useful guide on the cost of small amount, short-term loans.

Small Amount Credit Contracts typically run for between a couple of weeks and several months so an APR is misleading.

No consumer would take out a loan if they are quoted an APR of 365% or 626%. However, if they are told the dollar cost, they can then make an informed decision, as they do.

The following table shows how misleading APR values are for Small Amount Credit Contracts.

Loan Amount	Loan Term	Fee Charged	APR
\$100	1 day	\$1	365%
\$100	1 week	\$12	626%

To further demonstrate why Annual Percentage Rates are misleading, consider the following details of a \$1,000 loan with varying lengths of 1 year or less. In all cases, the consumer pays only \$100 in fees and/or interest.

Loan Amount	Term	Interest	Fees	Total Interest & fees	ANNUAL percentage rate	Payment
\$1000	52 Weeks	10% simple interest = \$100	Nil	\$100	10.00%	1 Single payment of \$1100
\$1000	52 Weeks	NIL	\$100	\$100	18.78%	26 fortnightly repayments
\$1000	13 Weeks	NIL	\$100	\$100	72.58%	13 Weekly payments

\$1000	4 Weeks	NIL	\$100	\$100	204.78%	4 weekly payments
\$1000	1 Week	NIL	\$100	\$100	521.80%	1 Single payment of \$1100

Appendix 7 - Price Controls Haven't Worked In The Past

In the 1990s, the State of Victoria imposed price controls on the pawn broking industry.

The controls failed to achieve the State Government's policy goal – to protect consumers by limiting the cost of transactions.

The controls also had the unintended consequence of forcing out legitimate businesses unable to make a profit, thus creating a void that was filled by illegal pawn brokers and criminal gangs.

Approximately two years later, at the request of the police and consumer advocates, this unviable price cap was lifted.

The current proposals for price controls are at odds with Government's own statements:

On the 4th Nov 2010, Prime Minister Julia Gillard described the regulation of interest rates as 'discarded economics' and stated: "*You certainly, in a modern economy, can't regulate interest rates*".

On the 15th Dec 2010, Treasury Secretary Ken Henry warned against interest rate controls. Although these statements were made in relation to the banks and funding, the same business logic applies to all credit providers and consumers (albeit on a small scale for our industry sector) under the National Consumer Credit Protection Act.

Appendix 8 - Users of Small Amount Credit Contracts

In the debate surrounding the Amendments, there is a lack of clarity and confusion on divisions between low-income consumers (often described as vulnerable and disadvantaged consumers) and the more than 500,000 consumers who need and use small amount, short-term credit responsibly without any issue.

Consumers that are neither disadvantaged nor vulnerable and do not qualify for the alternatives mentioned by Minister Shorten have not been recognised in this reform process to date. At the same time, they cannot or choose not to access small amount, short-term credit from the mainstream banking system.

The demand from this group of consumers will not go away. It is this group of consumers for whom we seek the changes (outlined in this submission) to the Government's proposed Amendments.

It is this group of consumers that have – when given a chance – complained strongly that they want to maintain their access to this form of funding.

In just two weeks, more than 30,000 Australians registered with Cash Converters their protest against the imposition of unrealistic caps on short-term loans. (see www.nocap.com.au)

While the Government, some media and consumer advocates have been keen to promote a picture of the industry based on isolated and outdated cases of consumer hardship, the true picture is that the vast majority of small amount, short-term transactions are carried out without hardship and without complaint.

Appendix 9 – Low Complaint Rate Means Restrictive Changes Unwarranted

The primary credit reporting agency in Australia, VEDA, notes from their research that “1 in 10 Australians have misrepresented their financial status when applying for credit”. Therefore it is not unexpected that cases of consumer detriment occur. The majority of those misrepresentations are picked up by credit providers during their assessment process and following Responsible Lending Obligations.

The Federation also acknowledges that unintended human errors / mistakes are made during loan assessment processes (as we are dealing with humans).

But aside from those rare cases, the facts are that the number of consumer complaints about loan transactions is exceptionally low compared with the total number of transactions carried out. This demonstrates that the complaint rate for the small amount short-term lending industry does not demonstrate market failure or justify the proposed prohibitive regulation.

In a report completed on 7 October, 2011 for the Federation, the Credit Ombudsman Service Ltd (COSL) found that in the 12 months of mandatory External Dispute Resolution ending 30 June, 2011, there were only 114 complaints with 94 of them closed.

Of the 94 complaints which were closed, these were their outcomes:

Outcome	Amount	%
Resolved in favour of Complainant	28	30%
Resolved in favour of both sides	24	26%
Resolved in favour of Member	3	3%
Complaint withdrawn	8	9%
No response from Complainant	19	20%
Changed Respondent	5	5%
Not within COSL’s jurisdiction	7	7%

That is, of the 94 complaints received, only 60 complaints were resolvable.

The 60 resolvable complaints are estimated by the Federation to represent an industry wide complaint rate of 0.005 of one per cent when compared to the estimated number of transactions per year.

By comparison and acknowledging the time difference, the Financial Ombudsman Service in its 2009-2010 Annual Review noted the receipt of 10,112 Credit related disputes for that period, up 17% on the previous period. It should be noted that small amount, short term lenders are not included in these figures as it was prior to being



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required to be a member of an External Dispute Resolution Scheme. Also, short term lenders generally have joined COSL rather than FOS.

<http://fos.org.au/annualreview/2009-2010/total-disputes-received.html>