



Briefing Paper BP5-2017

Responsible Lending: Lessons from Australia

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The Australian fringe finance sector has grown significantly in the last 15 years, despite efforts to better regulate the sector.¹ The number of households using high-cost, short term loans, otherwise known as payday loans, grew by almost 50 percent between 2005 and 2015.² Appliance and other rental arrangements, known in Australia as consumer leases, have grown similarly.

During this time, the regulatory framework has been reformed substantially. In July 2010, a single national consumer credit regulatory regime came into effect. This law required lenders, brokers and other intermediaries to be licensed and abide by a range of obligations, including the obligation to lend responsibly. In March 2013, a second wave of consumer credit reforms came into effect, regulating payday and other small amount loans.

Despite these reforms, there is now evidence that lending in this sector is not contributing to financial inclusion of vulnerable and disadvantaged people. A review of the regulatory framework in 2015 found that further reforms are required to ensure that the availability of consumer credit assists consumers onto the path of financial inclusion rather than exclusion.³

This paper will look at the nature and impact of the 2010 and 2013 reforms, as well as further reforms being proposed following the 2015 review. The paper will also provide comment about the likely eventuation and effectiveness of those proposed reforms.

¹ Zac Gillam, *Payday loans: helping hand or quicksand?*, September 2010, available at:

<http://consumeraction.org.au/wp-content/uploads/2012/05/PayDayLendingReport-FINAL.pdf>.

² DFA and Monash University, *The Stressed Financial Landscape*, October 2015, available at:

<http://consumeraction.org.au/wp-content/uploads/2015/10/The-Stressed-Financial-Landscape-Data-Analysis-DFA1.pdf>.

³ Danielle Press et al, *Review of Small Amount Credit Contracts Final Report*, April 2016, available at:

<http://treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/Consultations/2016/SACC%20Final%20Report/Key%20Documents/PDF/SACC-Final-Report.ashx>

The National Consumer Credit Protection Act 2009

The *National Consumer Credit Protection Act 2009* (the NCCP Act) was a reform package which harmonised existing state and territory consumer credit laws. It introduced a new National Credit Code and gave administrative and enforcement powers in relation to consumer credit to the Australian Securities and Investments Commission (ASIC). Much of the Act came into effect in July 2010.

The NCCP Act introduced a range of new conduct obligations and licence conditions for lenders and brokers. These included a requirement to maintain organisational training and competence; have adequate financial resources; have adequate compensation and insurance arrangements and be members of an approved external dispute resolution scheme.

A particular feature of the new regime was an obligation to lend responsibly.⁴ This required lenders to:

- Make reasonable inquiries about the consumer's financial situation, and their requirements and objectives for the loan;
- Take reasonable steps to verify the consumer's financial situation;
- Make an assessment about whether the credit contract or consumer leases are 'not unsuitable' for the consumer (based on the inquiries and information obtained in the first two steps).

While these laws were aimed at improving lending standards across both mainstream and fringe lending sectors, they did not specifically target the practices of fringe lenders. Rather, they applied broadly to all lenders. Following their introduction, ASIC developed detailed guidance about what is required to comply with this obligation.⁵ This made it clear that the primary objectives of the regime were to introduce standards to encourage prudent lending and leasing, and curtail undesirable market activities.

Case Law: The Cash Store

One of the first court cases to test the new responsible lending laws related to payday lender, The Cash Store.⁶ This lender first came to the attention of consumer advocates the mid-2000s, but it grew substantially during 2010 to 2014 to have over 80 outlets around Australia.

The Cash Store arranged short-term, low value loans usually to customers who were on low incomes. Loans up to \$2,200 (average around \$400) for periods between 1 and 36 days. The

⁴ *National Consumer Credit Protection Act 2009* (Cth), sections 128-132.

⁵ ASIC, *Regulatory Guide 209: Credit Licensing: Responsible lending conduct*, November 2014, available at: <http://download.asic.gov.au/media/2243019/rg209-published-5-november-2014.pdf>

⁶ [2014] FCA 926.

Cash Store would lend between 35 and 50 percent of the customer's next scheduled pay. Some customers had multiple and overlapping loans over the same period.

ASIC initiated action in 2013 relating to 325,000 credit contracts involving 52,000 customers. ASIC tendered a representative sample of 281 contracts for the purpose of establishing liability.

The court found that The Cash Store had systemically failed to comply with the responsible lending laws, with 277 of the 281 contracts examined breaching the law. In particular, it was found that there were no questions asked by the lender regarding the customer's expenses other than accommodation, that credit was advanced purely on the basis of a customer's capacity to pay the loan amount when due out of the next pay packet or social security benefit, and that the purpose of the loans stated on applications were insufficient ('personal' or 'living expenses'). The court ordered The Cash Store pay \$18.985m in penalties.

Small amount credit contract (SACC) reforms

In 2012, the Federal Government enacted further reforms targeted at part of the fringe lending market, that is, payday or cash loans. These reforms were designed to address particular risks associated with small amount lending, including the risk to consumers of falling into a debt spiral through the repeated or continued use of high-cost small amount credit contracts.⁷ The reforms included:

- A prohibition on credit contracts which are under \$2,000 and have a term of 15 days or less (short-term credit contracts);
- Certain caps for interest and fees for small, medium and other credit contracts;
- Presumptions of unsuitability, where applicants in default under another small amount credit contract, or where the consumer has had two or more loans in the last 90 days;
- Protections for consumers who receive 50 percent of their income in social security (that is, only 20 percent of their income would be available for repayments);
- Requirements to collect and consider bank account statements for the consumer for the preceding 90 days; and
- Required warnings and notices on premises and websites.

The fee caps for small amount credit contracts (loans under \$2,000 which have a term between 16 days and one year) were watered down during the legislative process.⁸ Initially, the caps were: a maximum allowable establishment fee of 10 per cent of the amount lent and a maximum monthly fee of 2 per cent of the amount lent. Following successful

⁷ Revised Explanatory Memorandum to the Consumer Credit Legislation Amendment (Enhancements) Bill 2012 (Revised Explanatory Memorandum), paragraph 11.89.

⁸ Ali et al, 'The politics of payday lending in Australia', *Monash University Law Review*, vol 39(2), available at: https://www.monash.edu/_data/assets/pdf_file/0017/141209/vol-39-2-ali-mcrae-and-ramsay.pdf.

advocacy from the industry, a parliamentary inquiry recommended the Government increase these caps to 20 per cent and 4 per cent. For a loan of one month, this cap would allow an equivalent annual interest rate of 264 per cent.

Allowable charges for medium amount credit contracts (loans between \$2,000 and \$5,000 repayable between 15 days and two years) are a one-off \$400 establishment fee and a maximum annual interest rate of 48 percent. For all loans of more than \$5,000 or with terms longer than 2 years and all continuing credit contracts such as credit cards, the fees and charges allowable are capped and must not be more than 48% annually (including any establishment or other fixed fees). This means that smaller loans effectively have a concession which allows them to charge more for credit.

In early 2015, ASIC released a report examining compliance with these new requirements.⁹ The report found substantial problems including:

- While most lenders collected bank statements, there were problems with lenders consideration of them;
- Two-thirds of loans reviewed involved the payday lender entering into a small amount loan with a consumer who triggered the presumptions of unsuitability;
- Ongoing problems with documentation and record keeping, including recording the purpose of loans.

ASIC also found that a number of lenders ceased lending small amount credit contracts to consumers who receive the majority of their income from Centrelink, while others continued to do so without appropriate assessments.

Consumer leases

While regulated under the NCCP Act, consumer leases have historically enjoyed lighter touch regulation. The legislation that introduced caps on small amount and other loans did not apply caps to consumer leases. It did require certain other protections in the National Credit Code that applied to credit contracts to be extended to leases, including provisions regulating unjust transactions and which require lenders to provide hardship variations.¹⁰ These protections did not apply to leases when the NCCP Act was first enacted.

Consumer advocates have raised concerns about the high costs charged by consumer lessors and the lax lending standards for many years.¹¹ These poor standards were

⁹ ASIC, *Report 426: Payday lenders and the new small amount lending provisions*, March 2015, available at: <http://download.asic.gov.au/media/3038267/rep-426-published-17-march-2015.pdf>.

¹⁰ National Credit Code, Schedule 1 of *National Consumer Credit Protection Act 2009* (Cth), sections 177B and 177F.

¹¹ Consumer Action Law Centre, *The hidden cost of 'rent to own'*, September 2013, available at: <http://consumeraction.org.au/report-the-hidden-cost-of-rent-to-own/>

exacerbated by what was seen to be inappropriate use of a direct debit service offered by Government for social security beneficiaries.¹²

There have also been concerns that consumer lease structures effectively are an avoidance or involve regulatory arbitrage—in substance, the transaction is the same as a loan but is structured as a lease to take advantage of lesser protections.¹³ ASIC also found that the costs charged by lessors can be more than 800 percent.¹⁴

Small Amount Credit Contract Review

In August 2015, the Government announced a review of the small amount credit contract laws—this review was required by the legislation that enacted the reforms in 2012.¹⁵ Responding to the community concern with consumer leases, the terms of reference included consumer leases.

Over thirty submissions were made to each of the review's issues paper and interim report. To inform their submissions, the Consumer Action Law Centre, the Financial Rights Legal Centre and Good Shepherd Microfinance jointly commissioned research from DFA Financial Analytics and Monash University Centre for Commercial Law and Regulatory Studies about financial stress in the community and the experience of payday loan borrowers.¹⁶ The research was based on an omnibus survey that interfaces with more than 26,000 Australians each year, looking specifically at the financial profile of these households. Among other things, the research found that:

- the number of households that had used payday loans in the past three years increased by 54 percent between 2010 and 2015;
- the average number of payday loans taken out by borrowers increased during the same period;
- the percentage of borrowers with concurrent payday loans increased from 12.6 percent in 2010 to 29.4 percent in 2015;
- that 19.6 percent of payday loan borrowers were in arrears or default on a payday loan in 2015.

¹² Financial Counselling Australia, *Centrepay: A good idea that has lost its way*, February 2013, available at: <https://www.financialcounsellingaustralia.org.au/getattachment/Corporate/Publications/Reports/Centrepay-A-Good-Idea-that-Has-Lost-Its-Way-February-2013.pdf>.

¹³ Ali et al, 'Consumer Leases and Consumer Protection: Regulatory Arbitrage and Consumer Harm' *Australian Business Law Review*, vol 41, 2013, summary available at: <http://consumeraction.org.au/summary-of-consumer-leases-and-consumer-protection-regulatory-arbitrage-and-consumer-harm/>.

¹⁴ ASIC, *Report 447: The cost of consumer leases for household goods*, September 2015, available at: <http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-447-cost-of-consumer-leases-for-household-goods/>.

¹⁵ Josh Frydenberg MP, Minister for Financial Services, *Media release: Review of the small amount credit contract laws*, 7 August 2015, available at: <http://jaf.ministers.treasury.gov.au/media-release/037-2015/>.

¹⁶ Above n 2.

This research confirmed the consumer advocates' casework experience and view that much greater reforms were needed to better protect borrowers. It also influenced the panel conducting the review.

In April 2016, the Final Report of the Small Amount Credit Contract Review was released,¹⁷ and in November 2016 the Federal Government responded to that report.¹⁸ In the Government response, it supported the recommendations to:

- retain the existing price caps on small amount credit contracts;
- extending the protected earnings requirement to all consumers (not just those whose predominant source of income is social security) and lowering the limit on repayments to 10 percent of the borrower's net income;
- applying this protected earnings requirement for consumer lease providers; and
- introducing a cap on the total payments under a consumer lease equal to the base price of the good plus 4 per cent of that price per month.

The protected earnings measures have been labelled affordability measures—the Final Report of the Small Amount Credit Contract Review stated that this was 'simple and effective way to reduce the harm that can be caused by repeat borrowing as it limits the possibility of a debt spiral occurring'.¹⁹

Other recommendations that providers should be prevented from unsolicited marketing and limits on default fees were also accepted by Government. In addition, the government supported introducing an anti-avoidance provision to overcome business models that get around provisions in the law.²⁰

Conclusion: a new era of safe finance?

As of June 2017, the Federal Government has not brought forward legislation to implement the recommendations of the Small Amount Credit Contract Review. Government representatives have indicated that legislation will be introduced and debated by the end of 2017.²¹

There remain risks that, as with the 2012 reforms, the proposals will be watered down during the parliamentary process. The National Credit Providers Association and the

¹⁷ Above n 3.

¹⁸ Kelly O'Dwyer MP, Minister for Revenue and Financial Services, *Media release: Government response to the final report of the review of the small amount credit contract laws*, 28 November 2016, available at: <http://kmo.ministers.treasury.gov.au/media-release/105-2016/>.

¹⁹ Above n 3, page 14

²⁰ See, eg, *ASIC v Teleloans Pty Ltd* [2015] FCA 648 which found that a particular credit arrangement operated outside the reach of the NCCP Act because of the language adopted in the contract.

²¹ Amy Baimbridge, ABC news, *Government urged to toughen payday lending and consumer lease laws*, available at: <http://www.abc.net.au/news/2017-03-27/government-urged-to-toughen-payday-lending-consumer-lease-laws/8387964>.

Consumer Household Equipment Rental Providers Association, the industry bodies representing the payday lending and consumer lease industries respectively, have publicly opposed the affordability measures described above.²² These industries have proven remarkably successful in their pursuits previously.

Noting that the price caps for both small amount credit contracts and consumer leases remain relatively generous, there also remains unanswered questions about the effectiveness of the proposed affordability mechanisms. Limiting repayments to 10 per cent of the borrower's income does ensure that the vast majority of that person's income is available for other essential purposes. However, for a low-income earner, consistently repaying 10 per cent of their income (or 20 per cent if they have both small amount credit contracts and consumer leases) over a long period of time may leave them without enough money to build savings or a buffer. It also does not seem to prevent ongoing reliance on high-cost credit. Time will tell whether the fringe finance industry is ever able to facilitate financial inclusion rather than exclusion.

The views expressed in this Briefing Paper are the views of the author and do not necessarily represent the views of CHASM as an organisation or other CHASM members.

²² NCPA, *Media release – small loans big need*, 6 April 2017, available at: <http://www.ncpa.net.au/publications/media-releases/2017/small-loans-big-need.html> and CHERPA, *Media release – Families to suffer due to forecast changes to consumer leasing laws*, 29 November 2016, available at: <http://cherpa.com.au/families-suffer-due-forecast-changes-consumer-leasing-laws/>.