

FRINGE CREDIT PROVIDERS

***DECISION-MAKING REGULATORY
IMPACT STATEMENT AND FINAL
PUBLIC BENEFIT TEST***

March 2006

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Executive Summary

Providers of credit can be broadly divided into “mainstream” and “fringe”. The former are made up of banks, building societies, credit unions, mortgage originators and national finance companies. The latter refers to all those credit providers on the fringe of the credit industry including, for example, payday lenders, micro lenders and elements of the non-conforming market.

The fringe credit market has diversified and significantly increased in size in the past few years and the uniform *Consumer Credit Code* (“the Code”), which regulates most consumer credit in Australia, may not be providing sufficient protection for clients of fringe credit providers.

Originally, the Code did not regulate the majority of fringe credit loans because s.7(1) of the Code exempted loans under 62 days. A 2001 amendment to the Code¹ extended coverage of the Code to include most short term lending. This amendment addressed many major issues with fringe credit lending by, for example:

- requiring contracts to be in writing;
- requiring the disclosure of fees and charges; and
- providing borrowers with the legal capacity to challenge unjust and unconscionable contracts.

It was acknowledged at the time of making this amendment that further reform may be needed to address additional areas of concern. This Decision-Making Regulatory Impact Statement and Final Public Benefit Test Paper (“the RIS”) analyses avenues for reform to the Code to address the problems which have emerged in the fringe market.

The RIS is based on a Discussion Paper which was released by the Ministerial Council on Consumer Affairs (MCCA) for public comment between 3 September and 10 October 2003. The original proposals in the Discussion Paper have been substantially reworked as a result of the submissions received.

Regulatory Impact Statement

The Council of Australian Governments “Principles and Guidelines for National Standard Setting and Regulatory Action by Ministerial Councils and Standard-Setting Bodies” require that proposals of this type be subject to a Regulatory Impact Statement. The present RIS estimates the benefits, costs and other impacts of the proposals, assesses the likelihood of the proposals meeting the Code’s objectives, and considers alternatives to the proposal.

¹ *Consumer Credit (Queensland) Amendment Act 2001*.

The specific objectives to be achieved in relation to the fringe credit market are to:

- Ensure fringe credit providers are complying with existing provisions of the Code and, where uncertainty exists, to clarify provisions in a way that is consistent with the policy objectives of the Code.
- Ensure that disclosure requirements and consumer protection mechanisms in the Code apply to all fringe credit loans irrespective of their structure.
- Enhance the “truth in lending” principle to ensure consumers are able to readily establish the true cost of loans, especially where an annual percentage rate (APR) is not stated, and fees and charges are a more significant cost of a loan than interest.
- To ensure there is adequate scope in the Code for consumers, including low income consumers, to remedy unjust terms in contracts or unconscionable interest, fees or charges.
- To address unfair and unjust conduct faced by vulnerable consumers in the fringe credit market, including problems caused when credit providers:
 - take security over a consumer’s essential household items; and
 - insist on the use of direct debit authorities to repay loans.

Options addressed

A number of options are considered in the RIS to address problems in the fringe market along with associated issues identified during consultation. These options have been assessed according to level of regulatory intervention. The following options are considered in the RIS:

1. Status Quo;
2. Industry self-regulation;
3. Minimal regulatory intervention including:
 - clarify that disclosure of an APR is required for all credit contracts;
 - close the loopholes identified in the Code; and
 - extend the application of existing remedies under the Code.
4. Greater intervention intended to provide more protection to vulnerable consumers including:
 - require extra disclosure requirements for “high cost loans” - in particular, including a comparison rate for each loan offer, a warning statement that the loan is a “high cost loan” and information about direct debit authorities; and
 - introduce a prohibition on taking security over household goods, alternatively, a prohibition on taking security for loans under \$3000.

Recommendations

1. *Status Quo*

The non-regulatory options that are assessed in the RIS in maintaining the status quo include:

- a) Better enforcement under the Code;
- b) Assisting consumers to achieve redress under the Code
- c) More communication activities about the Code
- d) Industry and community initiatives

The RIS makes the following recommendations in relation to maintaining the status quo.

STATUS QUO RECOMMENDATIONS

Option	Recommendation
Better enforcement under the Code	It is recommended that State and Territory consumer protection agencies develop a coordinated approach to Code enforcement in the fringe credit market.
Assisting consumers to achieve redress under the Code	It is recommended that State and Territory consumer protection agencies give consideration to encouraging submissions for targeted agency funding to assist fringe credit borrowers.
More communication activities under the Code	It is recommended that State and Territory consumer protection agencies develop a coordinated approach to fringe credit market education and communication activities.
Industry and community initiatives	It is recommended that State and Territory consumer protection agencies provide support and assistance to the development of industry education and communication programs.

2. *Minimal Regulatory Intervention*

The options for minimal regulatory intervention that are assessed in the RIS include:

- clarify that disclosure of an APR is required for all credit contracts;
- close the loopholes identified in the Code; and
- extend the application of existing remedies under the Code.

RECOMMENDATIONS FOR MINIMAL INTERVENTION

Option	Recommendation
<p>Clarify that disclosure of an APR is required for all credit contracts.</p>	<p>The Code should be amended so that it is clear that an APR must be provided for all loans where there is a charge for credit. This provision should be based on section 10B of the <i>Consumer Credit (NSW) Act 1955</i>.</p>
<p>Close the identified loopholes in the Code for:</p> <ul style="list-style-type: none"> • pawnbrokers • broker/credit provider arrangements • business purpose declarations • bill facilities exemption 	<ul style="list-style-type: none"> • It is recommended that the pawnbroker’s exemption be amended by providing that the exemption only applies where money is lent on the security of pledges of goods. The exemption should apply only where the sole recourse provided for failure to repay the loan is for the pawnbroker to sell or otherwise dispose of the goods pledged. • It is recommended that the Code be amended so that for the purposes of determining the amount of credit fees and charges that are imposed or provided under s.7(1) of the Code, a fee or charge is to include any fee paid to another party for referral to or from the credit provider irrespective of whether the party is related to the credit provider. • It is recommended that the conclusive presumption about a business purpose declaration be removed. • It is recommended that a regulation be made so that provision of consumer credit by way of bill facilities is not exempt from the Code.
<p>Extend the application of existing remedies under the Code</p>	<p>It is recommended that the existing remedies in the Code could be modified to:</p> <ul style="list-style-type: none"> • enable <u>all</u> fees and charges and the combination of interest, fees and charges to be reviewable under s.72 of the Code. The test for determining unconscionable fees and charges should be linked to the underlying costs or loss associated with the fee or charge. The test for determining unconscionable interest will be based on s70(2)(n) of the Code; • enable a court to consider fees and charges reasonably imposed by other credit providers in determining “unconscionable” interest and charges under s.72; • permit a court when considering an

	<p>application under s.72 to take into account the objective reasonableness of costs incurred in establishing or terminating a loan of that type;</p> <ul style="list-style-type: none"> • clarify the operation of s72(3) generally; • permit government consumer agencies to make applications under ss.70 and 72 of the Code.
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3. *Greater Regulatory Intervention*

The options for greater regulatory intervention that are assessed in the RIS include:

- require extra disclosure requirements for “high cost loans” - in particular, including a comparison rate for each loan offer, a warning statement that the loan is a “high cost loan” and information about cancelling direct debit authorities; and
- introduce a prohibition on taking security over household goods or alternatively, a prohibition on taking security for loans under \$3000;

RECOMMENDATIONS FOR GREATER INTERVENTION

Option	Recommendation
<p>Require extra disclosure requirements for “high cost loans” including:</p> <ul style="list-style-type: none"> • a comparison rate for each loan offer, • a warning statement that the loan is a “high cost loan”; and • information about cancelling direct debit authorities. 	<p>It is not recommended that the Code require further disclosure where the loan is a “high cost” loan;</p> <p>It is not recommended that tailored comparison rates for each loan offer be introduced; and</p> <p>It is recommended that the proposed extra disclosure requirements in relation to direct debit authorities apply to all loans including loans provided by mainstream credit providers.</p>
<p>Introduce a prohibition:</p> <ul style="list-style-type: none"> • on taking security over household goods, or alternatively; • a prohibition on taking security for loans under \$3000. 	<p>It is recommended that the Code be amended to prohibit the taking of security over essential household goods.</p> <p>It is not recommended that the Code prohibit the taking of security for any loans under \$3000.</p>

Introduction

Overview

Providers of credit can be broadly divided into “mainstream credit providers” and “fringe credit providers”. The former are made up of banks, building societies, credit unions, mortgage originators and national finance companies. The latter refers to all those credit providers on the fringe of the credit industry including, for example, payday lenders, micro lenders and elements of the non-conforming market.

The fringe credit market has diversified and significantly increased in size in the past few years and the uniform *Consumer Credit Code* (“the Code”), which regulates most consumer credit in Australia, may not be providing sufficient protection for clients of fringe credit providers.

Originally, the Code did not regulate the majority of fringe credit loans because s.7(1) of the Code exempted loans under 62 days. A 2001 amendment to the Code² extended coverage of the Code to short term, high return lending. This amendment addressed many major issues with fringe credit lending by, for example:

- requiring contracts to be in writing;
- requiring the disclosure of fees and charges; and
- providing borrowers with the legal capacity to challenge unjust and unconscionable contracts.

It was acknowledged at the time of making this amendment that further reform would be needed to address other areas of concern such as:

- the failure by some fringe credit providers to disclose annual percentage rates that assist borrowers to understand the cost of loans;
- the imposition of fees and charges that make the total cost of the loan very high;
- the taking of security over essential household items;
- misuse of direct debit authorities; and
- the avoidance of the Code’s provisions.

This Decision-Making Regulatory Impact Statement and Final Public Benefit Test Paper (“the RIS/PBT”) provides an overview of the fringe credit provider market and problems identified in the market. This RIS/PBT is based on a Discussion Paper which was released by the Ministerial Council on Consumer Affairs (MCCA) for public comment between 3 September and 10 October 2003.

² *Consumer Credit (Queensland) Amendment Act 2001*.

National Competition Policy Requirements

In April 1995, the Commonwealth, State and Territory Governments signed a set of agreements to implement National Competition Policy (“NCP”). Under NCP, each participating jurisdiction committed to implementing a series of competition reforms, including the review and reform, where necessary, of all legislation which contained provisions restricting competition. Each jurisdiction also agreed to subject new legislative proposals that contained measures restricting competition to a public benefit test (“PBT”).

The guiding principle for the NCP review of legislation, as contained in Clause 5(1) of the Competition Principles Agreement, is that legislation should not restrict competition unless it can be demonstrated that:

- the benefits of the restriction to the community as a whole outweigh the costs; and
- the objectives of the legislation can only be achieved by restricting competition.

This RIS/PBT identifies the costs and benefits of each option advanced to regulate the fringe credit market. Feedback provided on the options and the identified costs and benefits of each option has been incorporated into this analysis.

Regulatory Impact Statement Requirements

In addition to each State and Territory’s NCP obligations, a Regulatory Impact Statement (“RIS”) must be prepared on proposed changes to the Code. This RIS/PBT identifies the costs and benefits of each option advanced to regulate the fringe credit market. Information gained through consultation has enhanced the weight of the cost-benefit analysis contained in this RIS/PBT.

The key prerequisites for an RIS are that an initial assessment indicates regulation is necessary and the groups affected have been given, to the extent possible, advance notice of any new regulation or amendment and have been consulted adequately, unless there are very sound reasons for not taking such steps.

The Council of Australian Government’s “Principles and Guidelines for National Standard Setting and Regulatory Action by Ministerial Councils and Standard-Setting Bodies” requirements mean that the following are included in this RIS/PBT.

- **Overview of the industry:** an overview of the fringe credit market and borrowers who use fringe credit providers.
- **The problems sought to be addressed:** why government action is being considered in the fringe credit market, including identification of the problems sought to be addressed.
- **Objective:** the objective which the proposed Code amendments are intended to fulfil is stated in relation to the problems and how those problems might be fixed.

- **Statement of the proposed regulatory changes and alternatives:** this part of the RIS/PBT describes the proposed amendments to the Code and alternatives to allow comparative assessment and evaluation in the rest of the RIS/PBT.
- **Costs and benefits:** an outline of the costs and benefits of the proposals being considered including direct and indirect economic and social costs and benefits is included, as well as analysis of alternatives including maintaining the “status quo”.
- **Consultation:** this RIS/PBT outlines who has been consulted and provides a summary of the feedback provided during consultation by those who may be affected by the proposed action.
- **Evaluation:** an evaluation of the relative impacts of the proposals and alternatives is included to show that the desired policy objective cannot be achieved at a lower cost to business and the community at large.
- **Review:** consideration of how the effectiveness of the proposed changes to the Code will be monitored is included and is relevant to ensuring regulatory action remains justified in changing circumstances.

1. Overview of the industry and statement of the problem

This part of the RIS/PBT provides an overview of:

- fringe credit providers, and includes discussion about:
 - the size of the fringe credit industry;
 - mainstream lenders servicing the needs of low-income consumers;
 - characteristics of fringe credit providers; and
- borrowers who use fringe credit providers.

1.1 Fringe credit providers

The credit industry can be loosely divided into “mainstream credit providers” and “fringe credit providers”. The former are made up of banks, building societies, credit unions, non-bank mortgage originators and national finance companies. The latter refers to all those credit providers on the fringe of the credit industry such as payday lenders and micro lenders.

Some credit providers who may be covered by the term “fringe credit provider” - for example non-conforming lenders who are outside the mainstream of banks, building societies, credit unions and national finance companies - advised they did not consider themselves to be “fringe” credit providers and that another term such as “alternative credit providers” is more appropriate. However to avoid confusion, the expression “fringe credit providers” will be used in this RIS/PBT as it was in the Discussion Paper. It is not used as a pejorative term.

There appear to be diverse views about the description of the fringe credit market that was contained in the Discussion Paper. For example, not all fringe credit providers target borrowers at the bottom of the socio-economic ladder. Some lenders service higher income individuals seeking access to short-term, flexible finance options,

available quickly and with lower levels of administration (for example, “low-document” loans) than required by mainstream lenders. There is also no agreement that fringe credit providers solely service borrowers who mainstream credit providers are not willing or able to service. Some “mainstream” lenders provide loans to low-income consumers, sometimes using specialised products to service these consumers.

Size of the fringe credit industry

In August 2000, an independent working party was formed in Queensland to investigate the payday lending market. It found that the first payday lender started operating in Australia in December 1998³ and that although the market in 2000 was small, it was expected to grow rapidly over the next 5 to 10 years with predictions that 10 times the current number of outlets would be operating in as little as 5 years. The working party made this prediction based on experience in the United States where payday lending has expanded rapidly.⁴ The Consumer Law Centre Victoria study quoted industry estimates that the size of the payday lending market as \$200 million annually, with a customer base between 100,000 and 150,000 nationally.⁵

It is predicted the growth in the payday lending market in Australia will be extrapolated across the whole fringe credit market. This prediction is based on a number of factors. First, the United States, Canada and the United Kingdom have all experienced significant growth in the alternative financial sector. For example, payday lending has become big business in the United States. A Senior Vice-President of a leading investment firm recently stated that the turnover of the payday lending industry for 2000 involved 65 million transactions to 8-10 million United States’ households which generated \$2.4 billion dollars in fee revenue.⁶ In the early 1990s, there was only a handful of payday lenders in the United States and there are now an estimated 10 000 to 12 000.⁷ This growth has been attributed to the deregulation of the banking industry, the absence of traditional small loan providers and the elimination of interest rate caps in many States.⁸

Australian industry groups such as the Australian Finance Conference (AFC) are not confident the Australian fringe credit market would grow as quickly as the fringe credit market in the USA, because of considerable economic, social and regulatory differences.

Those who franchise fringe credit businesses describe the viability of the market and its strong potential for growth: “*The payday advance and short-term secured loans business is the most profitable small business in the world. There (sic) market is*

³ Queensland Office of Fair Trading, *Payday Lending – A Report to the Minister of Fair Trading*, Brisbane, 2000 at page 5.

⁴ Queensland Office of Fair Trading, above note 5, page i.

⁵ Consumer Law Centre Victoria, *Payday Lending in Victoria – A Research Report*, July 2002, page 41.

⁶ Consumer Federation of America/U.S. Public Interest Research Group 2001, *Rent-A-Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections*, page 6 in Consumer Law Centre Victoria, above note 4, page 25.

⁷ Consumer Law Centre Victoria, above note 5, page 25.

⁸ Ibid.

massive. It's untapped and under serviced in Australia.”⁹ “By satisfying the needs of the market, our business continues to grow”¹⁰; “City Finance Loans and Cash Solutions has a mass market to which to lend”.¹¹ “Payday advance and cheque cashing is one of the most explosive and fastest growing industries today!”¹²

While it is difficult to determine how large the fringe credit market will become, it appears that the market is still growing. It is not without significance that Cash Converters lenders in Victoria are now providing payday loans. It is also apparent that the size of the total dollar value of the market will likely remain relatively low compared to the well established home lending, credit card and personal loan market largely serviced by mainstream credit providers.

Mainstream lenders and community programs servicing the needs of low-income consumers

It was asserted in the Discussion Paper that factors indicating future growth in the fringe credit provider market are that mainstream credit providers such as banks are moving away from serving the needs of low-income consumers. Mainstream lenders do not typically lend for small amounts repayable over a fixed short term because the processing and administrative and reputation costs involved are too high. However, there was disagreement that there was a move away from this part of the market. For example, Credit Union Services Corporation (Australia) Limited (CUSCAL) advises that many credit unions have well-established relationships and continue to offer financial services to low-income earners. CUSCAL notes that many credit unions were established on the basis of people coming together to form a co-operative to provide financial services not able to be accessed in the mainstream market.

Community based organisations are also developing programs with mainstream lenders to enhance access to credit on reasonable terms to low income consumers. For example, the Brotherhood of St Laurence (BSL)¹³ is working in partnership with Bendigo Bank and the National Bank to pilot a program providing small loans to people on low incomes. These low interest loans provide affordable credit for the purchase of essential household equipment and establish a credit rating for entry into the mainstream credit system.

⁹ Red Lion Finance Group website - www.loansnow.com.au – “\$5,500 training” -19 May 2004

¹⁰ City Finance website - www.cityfinance.com.au - “Franchising”/“The Franchise” - 19 May 2004

¹¹ Ibid - “Franchising”/“Why This Business is Franchised” – 19 May 2004

¹² Australia Franchise Opportunities Exchange website - www.franchisedirectory.com.au/franchises/cashnow.aspx - 19 May 2004

¹³ The BSL also sponsored a conference in October 2003 entitled “Banking on the Margins – Promoting a More Financially Inclusive Community”. The objective of this conference was “to identify options for banking and financial services for low-income consumers and discuss reasons why these people are currently on the margins of banking in Australia.”

ANZ has commenced exploring¹⁴ the potential for Community Development Finance to “*meet the financial needs of people who do not have ready access to mainstream financial services, i.e. are financially excluded or underbanked*”. ANZ released a discussion paper in May 2004 and commissioned research into financial exclusion in Australia. In response to the results of that research, ANZ has committed to:

- Developing a loan program for consumers who may otherwise use payday lenders. ANZ will partner community organisations with expertise to deliver the program. These pilot programs commenced in January 2005.
- Initiate micro-finance programs including funding, financial literacy education, mentoring and support to facilitate the development of indigenous businesses, delivered with the assistance of local credit unions¹⁵.

Characteristics of fringe credit providers

There are various products offered in the fringe credit market such as payday loans, cash advances, short term loans and micro-loans. Broadly, “payday loans” refer to the lending of money repayable on the borrower’s subsequent paydays, often with no security taken but a borrower’s direct debit authority obtained to facilitate repayment. “Micro loans” refer to loans of relatively small amounts of money over relatively short periods and security over the loan may be taken. Although there is product diversification, fringe credit products typically have the following common characteristics:

- money is lent for many purposes, including purposes where traditional purpose-specific lending is not available such as for car repairs and dental care;
- consumers on low incomes may be targeted - for example: “*We try and help everyone*”; “*Pensioners welcome*”; “*No application refused*”; “*Discharged Bankrupts OK*”¹⁶ and money may be lent to those whose only income is welfare payments;
- the ease and speed with which money can be obtained is promoted;
- loans are for a short term ranging from one week to a couple of months, although a Consumer Law Centre Victoria study identified a trend towards many credit providers advertising larger and longer term loans¹⁷;
- money is often lent for a fixed fee or charge with a small or no annual interest rate, and some fringe credit providers disclose a monthly interest rate (in breach of s. 15(C) of the Code);
- a common method of repayment is via a direct debit authority, especially for payday loans; and
- loans are secured on a diverse range of personal property including vehicles and household items.

¹⁴ ANZ “Community Development Finance in Australia - A Discussion Paper” May 2004

¹⁵ ANZ “Community Development Finance in Australia – ANZ Response to Consultation” November 2004.

¹⁶ Southern News (Brisbane Queensland), May 20, 2004, pages 39 and 40

¹⁷ Consumer Law Centre Victoria, above note 5, page 9.

It was suggested that the payday/cash advance market tends to provide loans for 31 days or less and the micro lenders market tends to be for loans between 3 to 12 months. Loans provided by fringe credit providers can range from \$100 to \$10,000 with terms from 1 week to several years.

Instead of referring to the profit made on a loan as “interest”, some fringe credit providers charge a “fee” calculated as a percentage of the amount advanced. For example, the fee might be 20% of the amount advanced. Therefore, on a \$100 loan the borrower will be required to repay \$20. Some fringe credit providers “roll over” the loans in the sense that a borrower can increase the amount or period of the loan in exchange for an additional fee. Borrowers risk entering into a cycle of renewals of a fringe credit loan to delay final repayment, due to the short term of the loan and its high cost relative to the amount borrowed and the overestimation or disregarding of a borrower’s capacity to repay.¹⁸

In terms of defaults, a submission to the Queensland Working Party on Payday Lending in August 2000 said there are relatively low levels of defaults in the market, typically in the 2% to 3% range.¹⁹ However, there is clearly disagreement within industry about the rate of default, as some fringe credit providers advised during consultation that the default rate was up to 13% and many fringe credit providers say their form of lending costs more because of the higher risk of buyers defaulting.

Mainstream lenders do not typically lend for small amounts repayable over a short term because the processing and administrative costs involved outweigh the return on the loan, although credit unions provide products not offered by other mainstream credit providers. Credit unions are not-for-profit authorised deposit-taking institutions (ADIs) and operate on significantly smaller margins than other financial services providers.

There are a number of associations in the fringe credit providers market such as the Australian Cheque Cashing and Loans Association, the Financier’s Association of Australia, Australian Financial Services Association and the Microlenders Association of Australia. While consultation on the Discussion Paper revealed the extent of membership of some organisations, the proportion of the fringe credit market represented by these associations, individually and collectively, is unclear.

1.2 Borrowers who use fringe credit providers

A study by the Consumer Law Centre Victoria profiled the typical payday borrower. It found men and women are represented in fairly even numbers in the customer base of payday lenders and are most likely to be in their late 20s or early 30s. The average annual earnings of borrowers is approximately \$24,500, with a sizeable portion of borrowers earning less than \$401 per week. The study found the majority of borrowers were renting with many living in public housing and that loans were typically sought to pay bills or to cover day to day living expenses. Eighty percent of

¹⁸ Public Interest Advocacy Centre with Funding from Industry Canada, *Fringe Lending and “Alternative” Banking: The Consumer Experience*, November 2002, page 6.

¹⁹ Queensland Office of Fair Trading, above note 4, page 11.

loans were for less than \$350 and repeat borrowing was high.²⁰ Of course, not all borrowers in the fringe credit market fit this description. Some fringe credit borrowers are drawn from higher economic backgrounds and use fringe credit providers for reasons unrelated to their economic situation, including, for example, speedy approval of loans and convenient opening hours.

There may be increased demand for fringe credit products as increasing numbers of low-income consumers fall outside the lending criteria of mainstream credit providers and the number of people suffering from relative economic disadvantage grows.²¹ That there are an increasing number of Australians suffering from poverty and financial hardship has been discussed in a March 2004 report by the Australian Senate Community Affairs References Committee called "*A hand up not a hand out: Renewing the fight against poverty*"²². Estimates to the Committee from various sources including the research using the Henderson Poverty Line, the Smith Family and the Australian Council for Social Services all indicated that poverty in Australia is increasing.²³

For borrowers unable to access the mainstream credit market, there may be little choice but to borrow money from fringe credit providers if credit is required. There may also be a small number of borrowers who can access both the mainstream credit market and fringe credit market, but choose fringe credit loans.

When determining why consumers borrowed from payday lenders, the Consumer Law Centre Victoria found that borrowers 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.²⁴ However, borrowers did identify that the downside to such loans, which can be linked to the speed with which they can be obtained, are their very high costs and addictive nature.²⁵

Payday lenders and micro lenders said in response to the Discussion Paper that borrowers were sometimes not able to substitute fringe credit products with longer term mainstream loans such as personal loans or credit cards. Suggested reasons include that their clients do not qualify for credit cards or personal loans because of their credit or employment history. Recognition of this demographic is made in material that accompanies fringe credit franchise marketing:

"There are people in the community, young and old alike, who do not qualify for a bank personal loan or credit card, usually because their main source of income is Social Security or they have experienced prior difficulties which prevent them from obtaining funds. These are traditionally the people we are

²⁰ Consumer Law Centre Victoria, above note 5, pages 9 and 10.

²¹ Queensland Office of Fair Trading, *Fringe Credit Providers – A Report & Issues Paper*, Brisbane, 1999.

²² http://www.aph.gov.au/senate/committee/clac_ctte/completed_inquiries/2002-04/poverty/report/index.htm

²³ *ibid* at page 36

²⁴ Consumer Law Centre Victoria, above note 5, pages 9 and 10.

²⁵ *Ibid*.

*able to assist*²⁶, “*The payday and short term secured loan industry has come to the rescue of parents with sick children, people with broken down cars, workers that are paid only once a month and people from all walks of life who want to avoid bounced cheque fees, late credit card costs, late car payments and late mortgage payments.*”²⁷

2. The problems to be addressed

This part of the RIS/PBT outlines why government action is being considered in the fringe credit market, including identification of the problems sought to be addressed and includes:

- the role of the Code in addressing fringe credit market problems;
- the 2001 fringe credit amendments to the Code; and
- the problems to be addressed now.

2.1 The role of the Code in addressing fringe credit problems

The Code regulates most consumer credit in Australia. The Code is intended to apply the same rules to all forms of consumer credit - that is, credit for personal, domestic or household purposes. As can be seen from the description of the fringe credit market above, when the Code was introduced in 1994 very few, if any, lenders who could be described as fringe credit providers operated in Australia.

In its original form, s.7(1) of the Code exempted all loans under 62 days. This exemption was included in the Code to allow mainstream lenders to continue to allow customers to take out temporary overdrafts, bridging loans and the like without requiring extensive and potentially costly documentation which might deter lenders from offering temporary facilities. The majority of fringe credit loans, once they appeared in the marketplace, were not regulated as most were typically for less than 62 days.

2.2 The 2001 fringe credit amendments to the Code

Amendments made to the Code²⁸ in 2001 extended its coverage to short-term, high return lending. The amendments added two conditions to the 62 day limit to extend coverage of the Code. In particular, the amendments provided that if fees and charges for a loan exceed 5% of the amount of the loan and the interest rate exceeds 24% per annum, the Code will apply. As fringe credit providers normally charge in excess of 5% in fees or 24% interest, they are now captured by the Code. This amendment introduced the basic Code protections into the fringe credit market, including requiring contracts to be in writing and requiring the disclosure of fees and charges.

²⁶ City Finance website - www.cityfinance.com.au - “Franchising”/”Affordable loans for Battlers” – 19 May 2004.

²⁷ Red Lion Finance Group website - www.loansnow.com.au – “Industry overview” - 19 May 2004.

²⁸ *Consumer Credit (Queensland) Amendment Act 2001.*

2.3 The problems to be addressed now

It was acknowledged when the 2001 amendments were made that it was only the first step in regulating fringe credit providers and further reform would be needed to address other problems in the market. These problems, described here along with other issues identified during consultation in this evolving market include:

- the difficulty of identifying the true cost of loans, including failure to disclose annual percentage rates;
- imposition of fees, charges and interest that may be unconscionable and the difficulty encountered in challenging such charges and unjust contracts under the Code;
- taking security over essential household items;
- insistence on and use of direct debit authorities; and
- avoiding the application of the Code through;
 - exploitation of the pawnbrokers exemption;
 - a broker (or other intermediary)/credit provider arrangement;
 - a loan with a “business purpose declaration”; or
 - a loan using the bill facilities exemption.

Each of these problems is described in more detail in the following paragraphs.

2.3.1. The true cost of loans, including refusal to disclose annual percentage rates

The Code requires interest to be disclosed as an annual percentage rate (APR)²⁹. This allows consumers to make comparisons between credit providers and to understand the cost of credit, since interest expressed as an APR is a widely understood concept and makes it easy to compare loans. However, in the fringe credit market, credit providers may not charge borrowers an APR but instead, charge a flat fee or describe the interest charge as a monthly percentage interest rate without disclosing the APR.

Some problems stem from the practice of only imposing a flat fee. First, there is uncertainty about whether or not fringe credit providers who only impose a flat fee are required under the Code to disclose an APR. If a lender does not disclose an APR, it is hard for consumers to compare the cost of credit with loan products that disclose the cost of the credit in an APR. Interest is a widely understood method of referring to the costs of lending and APRs are widely used and understood by the community, however, a lender describing the interest on a credit product by reference to a monthly instead of an annual percentage rate will inhibit consumers from determining the cost of credit if that rate is compared with the APRs charged by other lenders.

Secondly, the imposition of only a flat fee represents a pre-determined credit charge. That is, the cost of borrowing the money is the same irrespective of whether the borrower repays the loan in 2 days, 2 weeks, 2 months or 1 year. Pre-determined credit charges do not reward good behaviour by a borrower in repaying the loan early.

²⁹ Section 15(C) of the Code requires annual percentage rate(s) to be disclosed.

The intention of the Code was to outlaw pre-determined credit charges by stipulating that interest may only be charged by application of the daily percentage rate to the unpaid daily balance which takes into account early and extra repayments and saves the borrower interest³⁰.

The policy of the Code is to require disclosure by the credit provider to allow consumers to shop around for credit and select the product best suited to them. This should result in price control through competition and to a large extent this has occurred in the mainstream credit market³¹. However, such price control is hampered in the fringe market because of a failure of some lenders to reveal APRs.

Where an APR is disclosed in advertising, a credit provider must also stipulate a comparison rate which is a rate that includes the APR and fees and charges relating to the loan and converts it into one single percentage figure. It follows that if there is not a nominated APR, there is no requirement to disclose a comparison rate in advertising, even if there is a large upfront fee. Borrowers of credit providers who charge only an upfront fee would therefore not get the benefit of being able to accurately compare products when these products are advertised.

2.3.2. Imposition of interest, fees and charges that may be unjust or unconscionable and the difficulty encountered in challenging such charges and unjust contracts under the Code

Unlike the previous *Credit Acts*, the Code allows credit providers to impose fees and charges on loans³². However, the primary intention behind permitting credit providers to impose fees and charges on borrowers was to allow credit providers to recoup the cost of establishing and administering the loan.

The intention of sections 72(3) and (4) of the Code is to allow a borrower to challenge certain specified fees and charges as being unconscionable if the fee or charge is in excess of the reasonable amount of the cost involved in determining the application for credit and administering the loan.

Only one reported case has been brought pursuant to section 72(3) and it was the recently decided case of *Director of Consumer Affairs Victoria v City Finance Loans and Cash Solutions*³³. The Director alleged that an establishment fee that was imposed by the credit provider was unconscionable. The difficulty that the Director faced was that the court held that it was bound to not just consider the amount of the fee but also consider the circumstances that existed between the parties. In considering this issue, the Tribunal imposed traditional notions of unconscionability.

The test for section 72(3) and (4) is linked to that particular credit provider's reasonable costs for establishing the facility. Fringe credit providers are setting large establishment fees on the basis that they are passing on to borrowers payments made

³⁰ See Part 2 Division 3 of the Code.

³¹ See for example the results of the research project commissioned by MCCA in 1999 – Malbon, J “*Taking Credit: A Survey of Consumer Behaviour in the Australian Consumer Credit Market*”, September 1999.

³² Section 15(G) of the Code requires the disclosure of credit fees and charges.

³³ [2005] VCAT 1989.

by the credit provider to brokers or intermediaries. In practice, the reasonableness of these costs is difficult to challenge because they are a cost that must be paid by the credit provider.

The class of fees is limited and many fees charged by fringe credit providers are not covered by s 72.³⁴ The Code also does not allow debtors to challenge as unconscionable the combined effect of interest, fees and charges. When taken together the combined effect of excessive fees, charges and interest that are imposed by fringe providers could be considered unconscionable.

To counter the increasing type and number of credit fees and charges, New Zealand has introduced a general ‘catch all’ provision for those fees and charges that are not specifically already challengeable.³⁵ New Zealand has used the test of ‘unreasonableness’ rather than unconscionable. A general test has been introduced which instructs the court to have regard to whether the fee compensates the credit provider for any costs incurred, is a reasonable estimate of loss and reasonable standards of commercial practice.

Some borrowers enter contracts where repayments can only be made in one lump sum or as a single large sum following many weekly or fortnightly payments of considerably smaller amounts. Other borrowers are lent amounts of money they have no hope of repaying within the time allowed for repayment without penalty. This can have the effect of forcing lower income borrowers to extend or “roll-over” the facility increasing the total amount of fees, charges and interest to be repaid. This is problematic in the fringe credit market where borrowers may be on very low fixed incomes and loan repayment cycles are short, resulting in fees and charges rapidly accumulating to the point where budgeted repayments cannot cover payment of additional charges on top of the initial fees, charges and interest payments.

There is scope in s.70(2)(1) for a court, in determining whether to reopen a credit contract, to have regard to a borrower’s ability to repay without substantial hardship. However, many borrowers in the fringe credit market are on low incomes and may not have the resources or skills to make such an application. Furthermore, the costs associated with making such an application for a small value short term loan could act as a disincentive. Consumer organisations, community legal centres or legal aid may provide some assistance, but as resources are also very limited for these organisations, the scope to take on case work is correspondingly limited.

The current review mechanisms allowed under the Code do not permit actions brought by classes of consumers or government consumer agencies (even though s.70(2) requires the court to have regard to the public interest). This limits the effectiveness of these provisions in addressing systemic problems with unjust or unconscionable contracts. Although Government Consumer Agencies could be given

³⁴ Examples of fees not covered include: *Application* (some lenders charge this fee in addition to an establishment fee); *Deferred establishment* (payable only if the loan is paid out inside a stipulated period); *Account management* (usually an ongoing fee on a fixed term loan); *Dishonour* (where a direct debit bounces, for example); *Late payment*; *Information*; *Replacement Statement* (an administration fee); *Production of transaction evidence*; *Extension*; *Phone call, letter and field call*.

³⁵ Section 41 *Credit Contracts and Consumer Finance Act 2003*.

standing to bring ss 70 and 72 actions, there are limits on the extent to which amendments to the Code could confer power to bring class actions.

There are two main issues with bringing ss 70 and 72 class actions under the Code. Firstly, the power to bring representative or class actions is governed by the rules of the tribunals or the empowering Code legislation in each State or Territory. In the absence of amendment in each State or Territory, amending the Code to refer to “class of debtors” is unlikely to achieve the purpose of facilitating class actions under the Code. Secondly, it is not clear that there would be sufficient commonality between debtors to justify the bringing of a class action under ss 70 or 72.

There are no powers in the Code to provide injunctive relief. The power to order injunctive relief will again depend upon the individual powers provided for in State and Territory rules and regulations. Forms of injunctive relief that may be available (depending on the State or Territory) include restraining a fringe provider from doing something, compelling it to do an act or perhaps cease trading. Such powers could be used by Government Consumer Agencies to enable a swift response to urgent cases of illegal behaviour by fringe providers. Consideration could be given by States and Territories to apply any relevant injunctive power that may exist in their fair trading legislation to Code actions.

From a broader perspective, there is no scope under sections 70 and 72 for a court to impose a civil penalty on a credit provider where unjust or unconscionable conduct warrants such a penalty. Therefore, litigation to correct such conduct by lenders does not have the effect of bringing about positive changes in practice, either from the individual lender the subject of the application or from other industry participants engaging in the same practices. The Commonwealth *Trade Practices Act 1974* and its mirror provisions in the State and Territory fair trading legislation have similar unconscionable conduct provisions to section 70. The unjust contract provisions in the New South Wales *Contracts Review Act 1980* are also very similar. In none of these cases are civil penalties provided for. This is because the general nature of the provisions makes it more difficult for business to be confident that it is not acting unconscionably or unjustly.

2.3.3. Taking security over essential household items

There is a concerning trend that fringe credit providers are taking bills of sale over essential household goods, including pots, pans, cutlery, crockery, fridges, tables and chairs, beds, children’s cots etc.

Bills of sale of this nature have been dubbed “blackmail securities” as the items of furniture required as security are often worth very little or nothing and are only taken as security to ensure repayments by the borrower through fear of losing the most basic and essential household possessions. They are rarely (if ever) actually repossessed by a credit provider because it is uneconomic to do so.

It has been reported by consumer organisations that some fringe credit providers use the threat of repossession to create a sense of fear for some borrowers. This can then give the fringe credit provider an effective priority over other lenders as borrowers maintain payment to the fringe credit provider for fear of having their essential household goods repossessed, even if bankrupt.

Requiring security over essential household items may be considered to be inconsistent with legislation protecting these items from forfeiture to satisfy other debts. The *Bankruptcy Regulations 1996* lists certain goods defined as “household property” as immune from creditors in the event of bankruptcy. Other legislation refers to the *Bankruptcy Regulations 1996* as the basis for exempting certain goods from repossession. For example, ss.828 and 917 of the *Queensland Uniform Civil Procedure Rules 1999* made under the *Supreme Court of Queensland Act 1991* provide that an enforcement officer is not permitted to take goods that are “exempt property” meaning “property that is not divisible among the creditors of a bankrupt under the relevant bankruptcy law as in force from time to time”.

2.3.4. Insistence on and use of direct debit authorities

Concerns have been raised regarding the use of direct debit authorities by fringe credit providers. The direct debit authority allows the credit provider to access the borrower’s bank account for a certain amount of money on a certain day or days. Some fringe credit providers repeatedly attempt to access bank accounts irrespective of whether there is money in the account. As a result, fees and charges are imposed on the borrower by the borrower’s bank. Many borrowers are not aware the direct debit authority can be cancelled by contacting their bank. Other concerns raised are that the fringe credit provider usually knows the date the borrower’s wage/pension will be deposited into the bank account. This gives the lender an effective priority over the borrower’s income, potentially at the expense of the necessities of life, such as food and housing.

2.3.5. Avoiding the application of the Code

A further emerging problem area is that some fringe credit providers are constructing their loans to avoid the application of the Code and thereby deny consumers the protections provided by the Code.

Avoiding the Code creates problems for consumers because the Code requires credit providers to present information about their loans in a written contract, including interest rates, fees, commissions and other information which may not be disclosed in a non-Code compliant loan. This information helps consumers make informed decisions, compare the cost of credit and encourages competition among credit providers. Coverage by the Code also enables consumers to have their contract changed to better meet repayments in certain circumstances such as hardship caused by illness or unemployment and as noted above, a court can order changes to a contract if it is considered unjust.

Specific types of conduct designed to avoid the application of the Code to consumer loans include setting up the transaction as:

- a pawnbroking arrangement;
- a broker (or other intermediary)/credit provider arrangement;
- a loan using a business purposes declaration; or
- a loan using the bill facilities exemption.

Each of these will be examined in the following paragraphs.

2.3.5(a) Pawnbroking arrangement

Pursuant to section 7(7), the Code does not apply to the provision of credit by a pawnbroker in the ordinary course of a pawnbroker's legal business, although ss.70 to 72 (court may reopen unjust transactions) apply to any provision of credit by a pawnbroker. Pawning personal belongings to obtain credit in times of need, where the amount is primarily determined by the value of the item(s) being offered is an age old practice. Pawnbrokers typically only provide credit for *less* than the value of the pawn. Research conducted by the Good Shepherd Youth and Family Service in conjunction with The Financial and Consumer Rights Council in 1997 found that in Victoria consumers estimated that they received about a quarter of the value of goods being pawned.³⁶

It has been identified that one way fringe credit providers attempt to circumvent the Code is by operating as a pawnbroker whereas in effect they are operating as fringe providers. Unlike traditional pawnbroking arrangements these fringe providers will not take a pledge but instead take a form of mortgage over the goods in exchange for providing credit.

The High Court recently considered what constituted "pawned goods" for the purposes of the *Pawnbrokers and Second-hand Dealers Act 1996 (NSW)* in *Palgo Holdings Pty Ltd v Gowans*. The majority noted that there is a distinct difference between a pawn or a pledge and a mortgage over property:³⁷

Pawn or pledges is 'a bailment of personal property, as a security for some debt or engagement'. They have identified such a transaction as distinct and different from mortgage where 'the whole legal title passes conditionally to the mortgagee'.

The Court held that a pledge is a transaction that is distinct from a chattel mortgage and in the case before the court a mortgage had been taken over the goods (and may therefore be subject to the Code). The key difference between the two types of transactions was that a chattel mortgage passes ownership of the goods to the lender whereas a pawn or a pledge is a form of bailment taken to ensure payment.

It is anticipated that using the pawnbroker's exemption as an avenue to attempt to escape the application of the Code is likely to become more attractive as more restrictions are placed on the operation of fringe credit providers, such as restrictions on taking security. Although such fringe credit providers would need to comply with state or territory pawnbroking laws and would need to go through the process of taking a pawn, this may be advantageous for them if they can continue their current practices.

³⁶ Good Shepherd Youth and Family Service in conjunction with The Financial and Consumer Rights Council, 'Fair Dealing? The Consumers' Experience of Pawnbroking in Victoria', March 1997.

³⁷ At 257 [17].

2.3.5(b) Broker/credit provider arrangement

It has been reported that fringe credit providers attempt to avoid the application of the Code by interposing a related but legally “arm’s length” intermediary – typically setting up a broker/credit provider arrangement. For example, fees are charged by a broker for referral to a credit provider but the broker’s fees are not counted toward the cost of the loan provided by the credit provider. The loan provided by the credit provider falls below the cost threshold for application for the Code in s.7(1) - 24% per annum and/or 5% in fees and charges - but the fees and interest for the whole transaction are actually above the threshold. The use of brokers or other intermediaries also has the effect of increasing the “reasonable costs” of an establishment fee that could otherwise be challenged as unconscionable under s.72 of the Code.

2.3.5(c) Loans using business purpose declarations

The pre-Code credit legislation had very restricted application. One of the revolutions achieved by the Code was to eschew any monetary ceiling by utilising a purpose-based test to determine which credit is covered. The relevant purpose is the purpose as at the time the credit contract is made.

Section 11(1) of the Code assists consumers by declaring that whenever a dispute arises about a credit contract, it is presumed that the purpose of the credit is personal, household or domestic - in other words (all other things being equal), it is Code regulated. If the credit provider wants to argue otherwise, it is up to them to prove the contrary.

However, if credit providers wish to avoid any argument about the purpose for which the credit was provided, s.11 is of great assistance. It states (s.11(2)) that if the debtor declares the purpose to be business or investment and makes a Business Purpose Declaration (BPD), this will be conclusive.

The BPD is a very convenient method for credit providers who lend for business or investment purposes to demarcate the contract as one to which - properly - the Code does not apply. Where a BPD has been signed, but the consumer wants to argue that in fact the Code should apply, the onus is squarely on the consumer to rebut the conclusive presumption that the Code does not apply.

Once again s.11 anticipates real life, and allows the otherwise conclusive presumption to be overturned where the credit provider knew or should have known that the credit was in fact for personal, household or domestic purposes. This is designed to prevent cynical credit providers from placing undue pressure on consumers or misleading them to sign away their rights. Even if the credit provider had no knowledge of the real purposes for which the credit was sought, the finance broker's knowledge will be imputed to the credit provider: s.11(4).

Consumer advocates have voiced strong concerns about the way in which BPDs have been used to enable fringe credit providers to avoid their obligations under the Code in circumstances where the Code ought to apply because the credit being sought is in fact for personal, household or domestic purposes.

The (Victorian) Consumer Credit Legal Service (VCCLS) has compiled a series of observations on the Code using funds from the Victorian Consumer Credit Fund. VCCLS asserts that the Victorian case law supports the proposition that provided a non-broker intermediary is used to obtain the BPD, the credit provider can avoid having to comply with the Code. This is because credit providers are not deemed to have any knowledge or information from the intermediary and nor are they obliged to quiz the intermediary.³⁸ Ironically the original version of s.11 did cover non-broker intermediaries, but since they may not have any connection at all with the borrower, it was thought unfair to shackle lenders with the consequences of behaviour over which they may have no control.³⁹

The VCCLS report states that motor car dealers often obtain BPDs where the finance is in fact for a vehicle for private use. Again the dealer is usually neither the lender nor a broker (though some dealers will be brokers) and therefore the credit provider is not seized of the dealer's knowledge. It may be that the dealer is not so much persuading the consumer to sign but rather, does nothing at all to enquire about purpose and presents the BPD as a *fait accompli* to the consumer, who is signing so many documents on the day that they do not notice and unwittingly sign away their rights.⁴⁰ As such, they lose the benefit of the Code's disclosure provisions and hardship provisions, quite apart from the procedural safeguards where default occurs and the lender looks to institute enforcement action.

Consumer Affairs Victoria has dealt with complaints that reveal systemic problems with the administration of BPDs. One problem, also discussed in the VCCLS report, is where consumers are led to believe (deliberately or otherwise) that the availability of any tax benefit in connection with the goods purchased on credit or the possibility that the goods might be used in connection with work obligations (e.g. using a home computer to do work) is enough to deem the credit to be outside the Code.

Another issue, not confined to BPDs, is the tendency for the courts and tribunals of different jurisdictions to vary in their approach. While the Consumer, Trader and Tenancy Tribunal of NSW recently overturned a BPD taken by a motor car dealership (*Daimler Chrysler Services Australia v. Berckelman & Anor*), Victorian consumer advocates avow that since *Neuendorf*, no-one has seen fit to challenge a BPD.

A summary of consumer detriment reported to regulators and described by consumer credit advocates consists of credit providers:

- who openly flout the legislation (e.g. by insisting that credit will only be available if a BPD is signed);
- who structure the execution of the BPD so that neither they nor a "relevant person" (see s.11 of the Code) is responsible for overseeing the BPD; and
- whose linked suppliers mislead consumers about the appropriateness of the BPD (e.g. sales protocols that confuse consumers).

³⁸ Reference is made to *Neuendorf v. Rengay Nominees Pty Ltd*, 3 September 2002, Victorian Civil and Administrative Tribunal.

³⁹ See McGill & Willmott, *Annotated Consumer Credit Code* at p.100.

⁴⁰ Despite the prominent warning that must be given under Regulation 10.

2.3.5(d) Loans using the “bill facilities” exemption

Pursuant to s.7(5), the Code does not apply to the provision of credit arising out of a bill facility. A bill facility is referred to in s.7(5) of the Code as a "facility under which the credit provider provides credit by accepting, drawing, discounting or endorsing a bill of exchange or promissory note". However, a regulation making power is provided in that section to apply the Code to "all or any credit arising out of such a facility".

The Department of Consumer and Employment Protection in WA has noted the emergence of fringe providers operating in the WA marketplace using promissory notes as a device to avoid the application of the Code. Similar examples have been noted in New South Wales using bills of exchange. In both cases, these companies target highly vulnerable consumers including Indigenous consumers and Centrelink recipients although it appears that for the most part this conduct has been confined to WA.

The profitability of these businesses appears to be reliant on borrowers defaulting on their debts, as reflected by one case the WA Department is aware of where an initial debt of approximately \$300 resulted in a debt of \$4,866 in a relatively short space of time. In this case the new repayment schedule entered into by the borrower provided for 98 repayments over the period from 1 April 2005 to 19 December 2008.

In June 2005, the Geraldton Magistrates Court advised that a fringe provider had lodged 137 applications for judgement summonses in the past 18 months (January 2004 to June 2005). The Geraldton Magistrates Court also advised that the number of appearances by clients of this single lender has increased from around two or three per week in early 2004, to the current rate of around 10 to 12 per week. Many clients appear a number of times for the same debt. Further, the Department has received reports of approximately 14 clients of the same lender appearing each week in both the Bunbury and Joondalup Magistrates Courts.

Based on statistics obtained to date, it can be conservatively estimated that in 2005, there will be at least 7000 appearances by consumers pursued through the courts for repayment of debts owed by these businesses operating in WA.

The use of the bill facilities exemption can be illustrated by the following case study provided by Fair Trading NSW. It is understood that this arrangement is based on a ‘successful’ UK model.

The consumer is provided with finance of \$2,500 to repair her car on the basis of a bill of exchange. The consumer’s monthly income is \$1,070 derived from a disability and carer’s pension. The bill of exchange forms the basis for the agreement that the credit provider will provide a ‘credit facility’ equal to the sum specified on the bill of exchange. The bill of exchange specifies the period, the amount (face value) and the interest to be paid per month expressed as a percentage. The bill of exchange is signed by both the credit provider and the consumer. The “credit facility” is conditional upon the consumer providing a signed:

- Bill Facility Agreement;
- vehicle mortgage; and

- Power of Attorney.

The consumer agrees to repay the sum shown on the bill of exchange by a repayment date specified in the Bill Facility Agreement. This agreement sets out the credit charges and payment date for those charges (in this case, \$375 per month). During the term of the credit facility, the consumer must pay a 180% APR based on the face value of each Bill of Exchange.

The credit facility is offered for 3 months and can be extended for a further 3 months if the interest is paid on time. The consumer is able to retain the use of the car throughout the term of the credit facility. The documentation makes it clear that the normal protections provided for under the Code do not apply. If the consumer fails to pay the interest and/or principal on the due dates the consumer is required to pay the following:

- Loan application fee - \$50
- Late payment advice letter - \$25
- Termination letter - \$50
- Repossession fees - \$500
- Interest after termination - 15% per month
- Legal fees - as incurred, plus 10% surcharge for admin.

The exploitation by consumer credit providers of the bill facilities exemption is clearly in conflict with the Code's policy objectives.

The Code does not define bill of exchange however its meaning is defined by s.8 of the *Bills of Exchange Act (Cth) 1909* which refers to "an unconditional order in writing, addressed by one person to another...requiring the person to whom it is addressed to pay...a sum certain in money". That is, a bill of exchange is essentially a negotiable instrument evidencing an assignable debt. Promissory notes are defined in the 1909 Act as "an unconditional promise in writing made by one person to another...engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money".⁴¹

In contrast to the traditional usage of bills of exchange where the bills are negotiated with institutions such as banks, the bill facilities being used by these credit providers are not being negotiated - the bill is retained by the credit provider and acts in a similar way to a traditional credit contract. Although the bills are not being negotiated, advice received about these bills of exchange and promissory notes is that they would still come within the broad definition of bills of exchange and promissory notes in the *Bills of Exchange Act*. Fringe credit providers have therefore had the benefit of the bill facilities exemption in the Code for the provision of the sort of consumer credit that was designed to be regulated by the Code.

⁴¹ Section 89 *Bills of Exchange Act (Cth)*

3. Objectives of Government intervention

This part of the RIS/PBT outlines the objectives of the proposed amendments to the Code in fixing the problems, particularly in relation to:

- the overall objectives of the Code; and
- the Government's objectives in the fringe credit market.

3.1. The overall objectives of the Code

The Explanatory Notes for the *Consumer Credit (Queensland) Act 1994*, to which the national Code is an appendix, states the objectives of the Code:

- to provide laws which apply equally to all forms of consumer lending and to all credit providers, and which are uniform in all jurisdictions in Australia;
- the legislation is based on the principle of truth in lending that will allow borrowers to make informed choices when purchasing credit;
- the Code applies rules that regulate the credit provider's conduct throughout the life of the loan, but without restricting product flexibility and consumer choice;
- the policy of the legislation is to rely generally on competitive forces to provide price restraint but to provide significant redress mechanisms for borrowers in the event that credit providers fail to comply with the legislation;
- the Code is designed to apply in a deregulated credit market and provide standards for the provision of credit that will not be overtaken by changes in the financial marketplace.

The NCP Review of the Code found these objectives are still relevant and appropriate in today's marketplace.⁴²

3.2. Objectives in the fringe credit market

The specific objectives in relation to the fringe credit market are to:

- Ensure fringe credit providers are complying with existing provisions of the Code and, where uncertainty exists, to clarify provisions in a way that is consistent with the policy objectives of the Code.
- Ensure that disclosure requirements and consumer protection mechanisms in the Code apply to all fringe credit loans irrespective of their structure.
- Enhance the "truth in lending" principle to ensure consumers are able to readily establish the true cost of loans, especially where an APR is not stated, and fees and charges are a more significant cost of a loan than interest.
- To ensure there is adequate scope in the Code for consumers, including low income consumers, to remedy unjust terms in contracts or unconscionable interest, fees or charges.

⁴² KPMG, NCP Review of the Consumer Credit Code Final Report, December 2001, page 11.

- To address unfair and unjust conduct faced by vulnerable consumers in the fringe credit market, including problems caused when credit providers:
 - take security over a consumers essential household items; and
 - insist on the use of direct debit authorities to repay loans.

4. Proposed Regulatory Options

The following options for achieving the objectives were considered:

1. Status Quo;
2. Industry self-regulation;
3. Minimal regulatory intervention including:
 - clarify that disclosure of an APR is required for all credit contracts;
 - close the identified loopholes in the Code; and
 - extend the application of existing remedies under the Code.
4. Greater intervention intended to provide more protection to vulnerable consumers including:
 - require extra disclosure requirements for “high cost loans” - in particular, including a comparison rate for each loan offer, a warning statement that the loan is a “high cost loan” and information about direct debit authorities; and
 - introduce a prohibition on taking security over household goods, alternatively, a prohibition on taking security for loans under \$3000.

In addition, stakeholder submissions on introducing interest rate caps in the Code are discussed.

The following sections describe the options in more detail.

4.1. Retaining the status quo

This option involves retaining the current law in the Code. This means that the Code will continue to apply to the provision of short term credit if the maximum amount of credit fees and charges exceed 5% of the amount of credit or the interest charges exceed the amount payable if the APR were 24% per annum.⁴³ The result is that the majority, if not all, fringe credit providers would continue to be subject to the Code in its current form, provided loans are not artificially structured to avoid the application of the Code.

Under the Code, credit providers are required to disclose essential information regarding the credit contract, provide written contracts and follow prescribed procedures when ending or enforcing credit contracts. Advertising of credit is regulated under the Code and the Code also provides some relief in the form of

⁴³ See section 7 of the Code.

allowing the reopening of credit contracts under certain circumstances such as unjust transactions.

There are some differences between States and Territories as to the implementation of interest rate caps. Interest rate caps were specifically exempted from the Australian Uniform Credit Laws Agreement of 1993. In New South Wales the maximum APR that can be charged by a credit provider is 48%. In the case of short term credit contracts in New South Wales, interest charges and all credit fees and charges under the contract are to be included for the purpose of calculating the maximum APR⁴⁴. The maximum APR in the Australian Capital Territory is also 48%. However, the Australian Capital Territory is proposing to include any fees or charges imposed by a credit provider into the calculation of the 48% maximum APR. In Victoria, the maximum APR for secured credit is 30% and for all other credit contracts, 48%.

4.1.1. Better enforcement of the Code

Aspects of consumer detriment in the fringe credit market could be addressed through regulators taking non-regulatory action under the Code.

Some jurisdictions are taking such action both under provisions of the Code that are uniform Australia-wide and for alleged breaches of interest rate caps, which are not uniform. For example, Consumer Affairs Victoria (CAV) is taking action against a fringe credit provider to have the difference between the real cost of establishing loans and the amount the lender charged declared unconscionable. In this fringe credit provider's contracts, the terms on a \$600 loan over a 36 week period included:

- a 30 per cent interest rate;
- a loan application fee of \$20;
- an establishment fee of \$350;
- a loan maintenance fee of \$2 per week;
- a \$20 fee each time the money was not in the bank when the direct debit was applied;
- a \$45 fee if they came to the clients' home in pursuit of the money; and
- a mortgage over household goods such as beds, chairs and tables and including essential items like refrigerators.

CAV will argue that the establishment fees are excessive. CAV also alleges these fringe credit providers engaged in unconscionable conduct in targeting socially disadvantaged people and then taking advantage of their needs and lack of expertise in financial contracts. CAV will be seeking an order that the alleged overcharged establishment fee and the loan maintenance fee be repaid to borrowers. It will also be argued that the APR was not properly declared in the credit contracts.

⁴⁴ See sections 7 and 7A *Consumer Credit (NSW) Special Provisions Regulation 1996*.

4.1.2. Assisting consumers to achieve redress under the Code

Consumers could take action themselves to remedy certain unjust or unconscionable contracts, interest changes, fees or charges. There are few actions brought under the Code as they are expensive given the practical difficulties involved in taking action on their own behalf. A greater number of consumer legal actions could be initiated if there was greater Government funding of community credit legal organisations.

4.1.3. More communication activities about the Code

Some jurisdictions have conducted credit communications campaigns that address, to varying degrees, information for consumers and businesses about fringe credit providers. These campaigns, such as Queensland's *Control your Credit* campaign have information gathering and assessment aspects that could inform further policy research and development in the fringe credit area.

There is scope for nationally coordinated campaigns to increase consumers' awareness of their rights under the Code. Currently, communication about the Code is focussed 'intra-state' without consultation with other states who may be undertaking similar education campaigns. Such coordination could be achieved at the departmental level through UCCCMC.

4.1.4 Industry and community Initiatives

Industry may proceed with the widespread implementation of loan programs for consumers who may otherwise use fringe credit providers.

These programs have been developed by community based organisations in partnership with mainstream lenders such as the National Bank and Bendigo Bank to provide no interest loan schemes (NILS) for essential household goods and also low interest loans. Similarly, ANZ has developed a number of initiatives aimed at addressing financial exclusion and lack of access by vulnerable consumers to appropriate low cost financial products and services. Should the pilot programs prove successful, they may be extended nationally. Other banks could also develop similar schemes aimed at providing credit to under-privileged consumers who may otherwise access the fringe credit market.

4.2 Industry self-regulation through a voluntary code of conduct

The Discussion Paper raised the option that representatives from the fringe credit market might develop a voluntary code of conduct to address the problems in the market.

While there are a number of advantages of a voluntary code of conduct, including for example, that market participants have the responsibility of developing and

administering the Code rather than government, it is questionable whether this would be a viable option given the current infancy of the industry.

In August 2000, the Report of the Queensland Working Party on Payday Lending raised serious doubts about the effectiveness of a voluntary code of conduct because there was no industry association in the payday lending industry and little co-operation between market participants. Furthermore, the Working Party found that each market participant seemed to be interested only in ensuring the growth and strength of its own organisation, as is normal in fledgling industries, with little consideration for fellow market participants.⁴⁵

While there are now more individual industry organisations, there is still no industry-wide coverage.

There is also an element of the fringe lending market which operates at the edge of (if not outside) the law that could not be managed by a voluntary code of conduct. Some other elements operating within the law operate for their own benefit and this market is unlikely to have an interest in limiting profit to address problems faced by borrowers.

It appears that a voluntary code of conduct would not be a viable option to address the problems in the fringe credit market, hence this option has not been analysed further.

4.3. Minimal regulatory intervention

The options for minimal regulatory intervention described below aim to clarify the current requirements of the Code, close some existing loopholes and provide enhancements for consumers. They are intended to be a minimal approach to addressing the issues/problems raised by the fringe credit industry.

4.3.1. Clarify that disclosure of an annual percentage rate (APR) is required for all credit contracts

There is currently uncertainty surrounding whether or not the Code requires fringe credit providers who charge a flat fee only to disclose an APR⁴⁶. It is arguable that at least some of the “fee” charged by fringe credit providers is a payment made by the borrower for the use of the borrowed money and is therefore interest or an interest charge. As such, an APR should be disclosed so that the cost of borrowing money can be compared. It is proposed to make clear that all credit providers must disclose an APR if the contract makes provision for any interest charge.

Such a provision could be based upon section 10B of the *Consumer Credit (NSW) Act 1995* which provides, that for the avoidance of doubt, credit providers must state an annual percentage rate on the basis of charges under the contract that are in the nature of interest charges (whether or not they are expressed to be an interest charge).

⁴⁵ Queensland Office of Fair Trading, above note 4, page 21.

⁴⁶ This is because section 15(C) of the Code requires disclosure of “[t]he annual percentage rate or rates under the contract” and not “an” annual percentage rate.

4.3.2. Extend application of existing remedies under the Code

Section 70 and 72 of the Code represent under utilised provisions that could, with amendment, be used to greater effect to challenge unjust and unconscionable practices of fringe credit providers.

Section 72 of the Code presently permits a court to review a small category of interest, fees and charges if they are unconscionable, namely a change to an interest rate or a establishment fee or charge; a fee or charge payable on early termination of a credit contract; and a fee or charge for a prepayment of an amount under a credit contract.

The Code could be amended to include a ‘catch all’ provision that would enable all fees and charges and the combination of interest to be reviewable as unconscionable. The intention of such an amendment is to create a statutory test for unconscionability and it is suggested that this test should be linked to the underlying costs or loss for fees and charges and the test for determining unconscionable interest will be whether it is excessive when considered with comparable cases.

Modifications could be made to section 72(3) and (4) to enable the court to consider the reasonableness of costs generally and not just whether the costs were those of the credit provider. In addition, section 72(3) could be clarified to confirm that the court is directed to consider only the matters that are included in section 72(3) and not other extraneous matters.

To allow for a greater number of sections 70 and 72 actions, Government Consumer Agencies should be given standing to bring actions. Such actions may require modification to the remedies that the court may order in section 71.

In summary, the existing remedies in the Code could be modified to:

- enable all fees and charges and the combination of interest, fees and charges to be reviewable under s.72 of the Code. The test for unconscionable fees and charges should be linked to the underlying costs or loss associated with the fee or charge. The test for determining unconscionable interest will be based on s70(2)(n) of the Code;
- enable a court to consider fees and charges reasonably imposed by other credit providers in determining unconscionable interest and charges under s.72;
- permit a court when considering an application under s.72 to take into account the reasonableness of costs (and not just the credit provider’s reasonable costs) incurred in establishing or terminating a loan of that type;
- clarify the operation of section 72(3) generally; and
- permit government consumer agencies to make applications under ss.70 and 72 of the Code.

Under the Australian Credit Laws Uniformity Agreement, the vesting of jurisdiction to resolve Code matters is a non-uniform matter. Such State and Territory legislation may or may not provide for class or group actions or for the making of injunctions. . As a long-term aim, the possibility of amending State and Territory Court and

Tribunal legislation to permit class or group applications under the Code should be explored.

4.3.3. Prevent fringe credit providers from avoiding the application of the Code by utilising exemptions in the Code

The proposals to amend aspects of the Code to prevent avoidance of the Code where loans are provided for personal, domestic or household purposes are outlined below.

(a) Pawnbrokers exemption

The Code could be amended to prevent fringe credit providers avoiding the Code by arranging a credit transaction as a quasi-pawnbroker arrangement. For example, s.7(7) of the Code could be amended to clarify that the exemption will only apply where a pledge is taken over the goods. It will not apply where ownership of the goods passes to the lender by way of a chattel mortgage. The exemption should apply where the only recourse provided for failure to repay the loan is for the pawnbroker to sell the goods pledged.

The intended purpose of this amendment is to close a loophole for those seeking to avoid the application of the code. If additional limitations are placed on the operation of fringe providers (for example, the taking of certain kinds of security) then loopholes such as this one are likely to be exploited if not remedied.

(b) Broker/credit provider arrangement

The Code could be amended to prevent fringe credit providers from setting up a broker/credit provider arrangement to avoid the application of the Code. For example, the Code could state that for the purposes of determining whether the 5% threshold of credit fees and charges is reached in section 7(1), a fee or charge is to include any charge paid to another party for referral to the credit provider.

(c) Misusing business purpose declarations (BPDs)

The Code could be amended to remove BPDs. This would benefit consumers who are unfairly prevailed upon to sign, unwittingly sign or sign BPDs based on misleading information, empowering them to argue that the presumption in s.11(1) that the Code applies shall stand. Consumers would not be disadvantaged by a conclusive business or investment purpose presumption.

(d) Bill facilities exemption

Regulations could be prescribed pursuant to s.7(5) of the Code to apply it to the provision of credit arising out of a bill facility. This would remove the loophole that has enabled credit providers to provide consumer credit by way of bills of exchange and promissory notes. The purpose of these amendments would be to capture bill facilities used for lending in the consumer market only. It is not intended that the amendments would have any effect on the commercial money market. The Code's application to credit provided for domestic purposes would limit the impact of amendments to exclude all forms of commercial lending.

4.4. Greater regulatory intervention

The options outlined below involve greater regulatory intervention. They would be combined with the minimal regulatory interventions outlined above and are intended to further the Government's objectives in the fringe credit market by providing greater protection through addressing unfair and unjust conduct by fringe credit providers.

4.4.1. Require extra disclosure requirements for “high cost loans”

The existing disclosure requirements in the Code could be modified to include:

- (a) providing a comparison rate for the particular loan offer;
- (b) statutory warnings; and
- (c) information about direct debit authorities.

The Code could be amended by introducing a new layer of regulation for “high cost” loans. These types of protections are loosely based on the *US Home Owners Equity Protection Act*⁴⁷ which imposes additional requirements on high interest rate loans.

A “high cost” loan would need to be defined. There are two options:

1. a high cost loan is where the comparison rate is greater than the 90 day Bank Accepted Bill (BAB)⁴⁸ rate plus 25 percentage points; or
2. a high cost loan is where the comparison rate is greater than 30%.

The purpose of setting a threshold is to require loans above the threshold to comply with additional disclosure requirements. The threshold does not prohibit interest rates/fees above that rate.

These proposals are discussed under the relevant headings below.

(a) Providing a comparison rate for the loan offer

The *Consumer Credit Code (Queensland) Amendment Act 2002*, which amended the Code, commenced in July 2003. The amendments require a comparison rate to be included in any advertisement for a fixed term credit product that contains an APR and that a credit provider must display, and have available for collection by members of the public, copies of a comparison rate schedule.

The first proposed requirement would be that credit providers would need to state the comparison rate in the high cost loan offer. This may impose an additional requirement to calculate the comparison rate for those credit providers that rely only on the standard comparison rate schedules. A comparison rate is a method of calculating the total cost of a loan, including interest and all non-contingent, non-

⁴⁷ 15 U.S.C.

⁴⁸ This rate is the generally accepted measure of the underlying cost of money at any given point in time and is easily accessible in the major daily press (eg The Financial Review, The Australian and major State newspapers) and from the Reserve Bank of Australia, including the website www.rba.gov.au)

government fees and charges, to a single percentage rate. This would allow consumers to compare the overall cost of a high cost loan with other high cost loans and other loan products in the market.

Under this proposal, credit providers would disclose the actual comparison rate for the particular high cost loan on the offer document so that the true cost of the loan is more readily apparent.

(b) Direct debit authorities

The second proposed requirement is that if a consumer signs a direct debit authority for repaying a high cost loan, the credit provider would be required to disclose the following in writing to the consumer:

- the consumer can cancel a direct debit authority at any time by contacting the holder of the authority (for example, their bank, credit union or building society);
- the consumer can lodge a complaint with the holder of the authority if there has been an unauthorised debit (for example, accessing the account on days not specified on the authority or for amounts not specified on the authority); and
- the consumer can contact their consumer affairs/fair trading agency or the Australian Securities and Investments Commission (ASIC) for assistance in resolving complaints regarding unauthorised debits.

(c) Statutory warnings

The third proposed requirement is that credit providers who offer high cost loans would be required to disclose a statutory warning before the contract is signed which would warn consumers that the particular loan is an expensive form of credit. For example, the warning statement might be:

WARNING

THIS LOAN IS A HIGH COST LOAN UNDER THE CONSUMER CREDIT CODE

CONSUMERS SHOULD COMPARE THE COST OF THIS LOAN TO OTHER
LOANS AVAILABLE BEFORE ENTERING INTO THIS AGREEMENT

4.4.2. Amending the Code to introduce a prohibition on taking security over household goods or alternatively, a prohibition on taking security for loans under \$3000

The Code could be amended to prohibit the taking of security over essential household goods. The definition of “household property” could be drawn from the Commonwealth *Bankruptcy Regulations 1996*, which lists goods immune from creditors in the event of bankruptcy. By way of example, the types of goods defined as “household property” include (but are not limited to) kitchen equipment, cutlery, crockery, foodstuffs, heating equipment, cooling equipment, telephone equipment, bedding, linen, towels, sufficient household furniture and beds for the members of the household, 1 television set and 1 set of stereo equipment.

The Discussion Paper also suggested the prohibition could extend to taking any form of security for loans under \$3,000.

4.5. Stakeholder submissions on introducing interest rate caps into the Code

The relatively high fees charged for a fringe credit loan might be considered unjust and unconscionable. The Code allows a borrower to apply to Court to determine whether changes to interest rates or certain charges are unconscionable in certain circumstances⁴⁹. However, many borrowers in the fringe credit market are on low incomes and may not have the available resources or skills to make such an application. Furthermore, the costs associated with making such an application for a small value short term loan would act as a disincentive. Consumer organisations or legal aid may provide some assistance, however resources are also stretched for these organisations. Therefore, the current application process allowed under the Code may not be adequate for borrowers in this market, even if changes to the Code were made enabling class actions or government consumer agencies to challenge interest rates, as actions would still be contingent on funding being available.

One way to address the problems related to the imposition of fees that translate to exorbitant rates of interest is for jurisdictions to implement an interest rate cap. The Code is based on the Australian Uniform Credit Laws Agreement of 1993 in which each State and Territory agreed to maintain uniform legislation in the area of consumer credit. However, interest rate caps are not covered by the uniformity agreement. Consequently, each State and Territory is free to determine whether they implement and maintain interest rate caps.

At this time three jurisdictions have implemented caps. In New South Wales the maximum APR is 48%, and in the case of short term credit contracts, interest charges and all credit fees and charges under the contract are to be included for the purpose of calculating the maximum APR⁵⁰. The maximum APR in the Australian Capital Territory is also 48%. However, the Australian Capital Territory is proposing to include any fees or charges imposed by a credit provider into the calculation of the 48% maximum APR. In Victoria, the maximum APR for secured credit is 30% and for all other credit contracts, 48%.

Whilst Western Australia does not, at present, have a maximum interest rate cap in place, it does have a provision in place within the Western Australian Code (the *Consumer Credit (Western Australia) Act 1996*) which allows for regulations to be made to require all interest charges and all other fees and charges relating to the provision of short-term credit to be included for the purpose of calculating the maximum APR. This is similar to the New South Wales model.

In those jurisdictions that have interest rate caps in place, there are difficulties in applying caps to loans that impose just a fee or charge and no interest as such. For example, a fringe credit provider operating in Victoria allegedly restructured its credit

⁴⁹ Section 72 of the Code.

⁵⁰ See sections 7 and 7A *Consumer Credit (NSW) Special Provisions Regulation 1996*.

product to avoid the interest rate cap of 30% for secured loans. Prior to the introduction of the cap the credit provider was charging 43% per annum interest and imposing a \$350 application fee on secured loans. The credit provider then reduced its interest rates to 29%, but increased its application fee to \$415. The money paid back by the borrower is the same, but complies with the interest rate cap. As noted above, to address this issue, New South Wales has introduced a maximum APR of 48% for short term credit contracts which requires interest charges and all credit fees and charges under the contract to be included for the purpose of calculating whether the APR exceeds the 48% maximum.

Some jurisdictions, such as the Australian Capital Territory, are reviewing their cap and it is proposed to include fees or charges imposed by credit providers into the calculation of the maximum interest rate. This would prevent fringe credit providers from reducing interest rates and increasing fees/charges to get around the interest rate cap.

As interest rate caps are specifically excluded from the uniformity agreement, there is no regulatory power to implement them at a national level. National implementation of interest rate caps would need to be by amendment of the uniformity agreement at a ministerial level. It is therefore not appropriate to conduct a regulatory impact analysis of this option. For those States and Territories that have not implemented interest rate caps, consideration of the impact of such proposals will need to be undertaken at a State level.

Given the exclusion of interest rate caps from the uniformity agreement, further analysis of this option has not been undertaken.

5. Costs and benefits of the proposals

This part of the RIS/PBT contains an outline of the costs and benefits of the proposals being considered. This includes direct and indirect economic and social costs and benefits, as well as analysis of alternatives including maintaining the “status quo”.

Those groups primarily affected by the problem and the proposed solution are:

- fringe credit providers (and new entrants to the market);
- borrowers, which refers to ordinary persons who seek credit predominantly for personal, domestic or household purposes; and
- State and Territory governments.

5.1 Retain the Status Quo

The current regulatory framework generally applies to most, if not all, fringe credit providers. The Code applies to the provision of short term credit if the maximum amount of credit fees and charges exceed an amount payable if the APR were 24% per annum. This means that credit providers will continue to be subject to the Code provided they do not structure their loans to avoid the application of the Code.

5.1.1 Costs/disadvantages of status quo

Costs to fringe credit providers

- Participating in the conduct identified in Part 2 of this RIS may reduce consumer confidence in the fringe credit provider market – resulting in a limited class of borrowers (those who believe they have no alternative) entering the fringe credit market. This could hamper demand and prevent the industry from growing.
- Continued grouping of micro lenders and payday lenders as “fringe credit providers” will lead to an undeserved impact on the reputation of Code compliant lenders.

Costs to borrowers

- Borrowers will continue to have only the limited rights available in the Code to bring actions against credit providers, hence borrowers will still bear the cost of individual actions. The prohibitive cost of these actions may result in a continuation of the small number of claims currently brought by borrowers.
- Borrowers of credit providers who avoid the application of the Code will remain disadvantaged as they will not have the protection of the Code’s disclosure provisions and remedies.
- Borrowers may continue to find it difficult to discover the true cost of loans and compare products.
- Marginal borrowers will continue to be put under pressure to use essential household items as security, placing them at risk of emotional distress, even if the items are not actually taken.

Costs to mainstream credit providers

- There are no costs that could be identified for mainstream credit providers under this option.

Costs to governments

- Increased ongoing funding of consumer agencies would be required if their enforcement roles are to be increased.
- Will continue to face costs associated with impacts of the problems, including demand on community and Government services when consumers are faced with financial or emotional crisis resulting from unfair or unconscionable loans or loan conditions.
- Will continue to feel pressure from consumers, organisations representing consumers, and the community to address problems in the market.

5.1.2 Benefit/advantages of status quo

Benefits to fringe credit providers

- The current remedies and disclosure requirements will remain unchanged for all credit providers. This will provide certainty for credit providers.
- Disclosure under the Code will remain the same. This will mean that credit providers do not have to invest time and money into developing alternative systems.
- The Code's existing framework applies evenly across all forms of credit providers, both mainstream and fringe. Both groups have to comply with the same disclosure requirements, and be subject to the same remedies.
- Credit providers that avoid the application of the Code through various loopholes will be able to continue their practices unchanged.
- Fringe credit providers will be able to continue to obtain security over household goods.

Benefits to borrowers

- Borrowers will have the protection of having contracts in writing, disclosure of fees and charges and the capacity to challenge unjust contracts, provided the loan is not structured to avoid the Code.
- Can continue to access credit from the fringe credit market that may not be available to them, for a variety of reasons, from mainstream lenders.
- Accessing finance gives consumers the opportunity to purchase/pay for essential items, services and for other reasons.

Benefits to mainstream credit providers

- Retaining the status quo avoids the risk of unnecessarily or inadvertently imposing new costs on mainstream credit providers.

Benefits to governments

- Governments will save on initial and ongoing administrative costs associated with amending the Code and developing other forms of regulation.

5.2. Minimal regulatory intervention

Detailed below are minimal regulatory options that could be employed to address the concerns about the fringe lending industry.

The following subsections describe each of these possible amendments to the Code and the costs and benefits of each option. The potential impacts should be regarded as being assessed against the status quo.

5.2.1. Disclosure of Annual Percentage Rate (APR)

5.2.1.1 Costs/disadvantages – Annual Percentage Rate

Costs to fringe credit providers

- It is unclear how many fringe providers are not currently disclosing an APR. For those credit providers who do not currently disclose an APR, they may face extra administrative costs in determining the APR. These administrative charges may include updated software programs to calculate the APR together with user training. Documentation will also need to be amended to include the rate. This cost would be of a short-term nature and is not likely to impact greatly upon the business.
- It is possible that a small proportion of fringe credit providers may face a decrease in demand due to some borrowers reassessing loans and possibly seeking out lower cost loans as the cost of credit is made clearer. In a competitive market, fringe providers may need to lower the cost of credit to maintain business resulting in a loss of profits. However, lower cost fringe providers may note an increase in business which may offset any loss of profits noticed by higher cost credit providers.

Costs to borrowers

- There is the possibility that the unknown proportion of fringe credit providers will pass on any extra ongoing administration costs to consumers. However, it is reasonable to assume that these costs would not be high as they would be limited to those initial costs expended by fringe credit providers in updating software programs and any extra training of staff that may be required. These costs that may be passed on would be limited to the fringe credit providers who are not currently disclosing an APR.
- Additional disclosure generally of itself may not be effective in influencing borrowers' choices where the circumstances faced by some borrowers mean that there is limited competition in the market accessible to them.

Costs to Government

- There would be initial administrative costs associated with amending the Code and educating both consumers and credit providers of the amendment. This cost is likely to be of a short-term nature.
- There is likely to be an increase in ongoing enforcement costs above that noted for maintaining the status quo as a greater number of provisions would need to be monitored. This would particularly be the case in the short term following the amendments to ensure that the new provisions are understood and being complied with.

Costs to mainstream credit providers

- It is unlikely that the clarification of Code provisions requiring credit providers to disclose an APR would impact on mainstream credit providers, or their borrowers, as they typically disclose an APR.

5.2.1.2 benefits/advantages – Disclosure of Annual Percentage Rate

Benefits to fringe credit providers

- The reputation of the fringe credit market may improve as a result of the disclosure of an APR because the costs of loans would be clearer to consumers. However it is reasonable to assume that any benefit with respect to reputation, unquantifiable as it may be due to its intangible nature, is likely to be small given that the APR that is expressed is likely to be relatively high, reflecting the increased allowance made for the risk involved.
- Those fringe credit providers who currently disclose an APR will be able to compete on an equal footing with those who currently do not disclose an APR.

Benefits to borrowers

- If fringe credit providers who charge fees that are in the nature of interest, disclosed an APR, there would be a consistent basis on which the cost of loans would be provided and this may stimulate competition.
- As the cost of borrowing money becomes more transparent and fringe credit providers start directly competing with each other, there is a possibility that interest costs will decrease.
- A central objective of the Code is to enhance “truth in lending”. This proposal aims to address concerns that information available to borrowers in the fringe market does not allow prospective borrowers to adequately compare products. If consumers are to make informed financial decisions, they need to be able to compare credit products and determine the expected costs. As noted above, research on consumer behaviour in the consumer credit market indicates a vast majority of people compare interest rates between credit providers when deciding which credit provider to borrow from and a majority of consumers find it relatively easy to compare interest rates.⁵¹ Therefore, clarifying that all credit providers must disclose fees in the nature of interest as an APR will help borrowers who are given this information. This may prevent some borrowers from paying too much for credit.

Benefits to government

- In assisting borrowers to be provided with an APR for fees that are in the nature of interest, Governments would clarify an existing provision of the Code consistently with the Code’s objective of requiring “truth in lending” that will help borrowers to make informed choices when purchasing credit. This may prevent some borrowers from getting loans they cannot repay without hardship and thus needing to access government or community support facilities. Clarifying this issue would ensure disclosure requirements under the Code apply to all forms of consumer lending and to all credit providers.

⁵¹ See ‘*Talking Credit – A Survey of Consumer Behaviour in the Australian Consumer Credit Market*’ Malbon, J., Law School, Griffith University, September 1999, and in particular 9.2.3, pages 58 to 60.

- There is unlikely to be an increase in ongoing enforcement costs above that noted for maintaining the status quo.

5.2.2. Extending application of existing remedies under the Code

5.2.2.1. Costs/disadvantages – extension of remedies under the Code

Costs to fringe credit providers

- A small proportion of fringe credit providers may face the loss of a charge (including an interest charge) or fee if a court finds it is unconscionable. This impact would be felt by fringe credit providers who charge fees in addition to those currently captured by s.72. Hence, this measure is likely to place pressure on these businesses to reduce their charges, which may affect their profitability. Some marginal credit providers are likely to become unprofitable, so could be forced to close.
- There may also be the direct costs for affected businesses of legal costs to defend any increase in challenges to their fees/charges and perhaps the possibility of compliance costs being incurred to alter their business practices to comply, in addition to the direct costs of complying identified above.
- Fringe credit providers who impose unconscionable interest, fees or charges would face a greater likelihood of having that fee or charge reviewed by a court because of the increased scope for applications by government consumer agencies to have such fees and charges reviewed.
- Those fringe credit providers that are found to have breached the unconscionable provisions will face substantial costs including court costs and/or compensation orders that may be imposed.
- Fringe credit providers would need to compete directly with each other if, under s.72, a court was permitted to take into account reasonable interest, fees and charges imposed by other credit providers.

Costs to borrowers

- It is unlikely borrowers will suffer any direct costs or disadvantages if the existing remedies contained in the Code were extended as proposed. However, new or extended business regulation can sometimes affect the willingness of business to be innovative, which can result in an opportunity cost for consumers (in this case, borrowers). It is anticipated that the risk of this is low in this case, as courts are likely to take into account valid reasons for higher costs, but nevertheless it is a possibility.

Costs to mainstream credit providers

- These amendments are unlikely to impose any significant costs on mainstream lenders as they would not generally charge interest and fees that are likely to be considered unconscionable. There may be some costs if interest, fees and charges are challenged by consumers as being unconscionable that were not previously subject to such challenge.

Costs to governments

- There may be pressure on governments to take action to assist consumers who are subject to unjust contract terms or unconscionable interest, fees or charges. This may result in increased ongoing compliance and enforcement costs to consumer agencies above those resources allocated for maintaining the status quo.

5.2.2.2 Benefits/advantages – extension of remedies under the Code

Benefits to fringe credit providers

- This option may benefit those fringe credit providers who do not charge unconscionable interest, fees or charges and assist them in competing with those who apply such charges.
- Court decisions in cases that arise from these changes may give guidance to the fringe lending industry as to the appropriateness of interest levels and fees and charges.

Benefits to borrowers

- Borrowers will benefit by having a wider range of unconscionable fees and charges potentially reduced as a result of participating in successful court actions. This benefit may extend to a wider class of borrowers as a result of changes to industry practice as the appropriate standards for the fringe industry are established following court decisions.
- A more generic provision will keep pace with new fees and charges devised by fringe credit providers and ensure that the above benefit will continue to be available.
- The scope for a consumer to have a court review the combination of interest, fees and charges to determine whether as a totality they are unconscionable will lead to a more realistic application of such charges. This may take away the incentive on fringe credit providers to avoid using an APR or obtain cost recovery (through the fees and charges listed in s.72) by artificially moving charges away from the limited categories of interest, fees and charges currently subject to review under the Code so the benefit is expected to be lower fees and interest charges.
- Borrowers, who have no financial capacity, lack the necessary skills and confidence or are unable to access legal assistance from legal aid or community legal centres may be able to have an unconscionable interest rate, fee or charge challenged by government consumer agencies.

Benefits to mainstream credit providers

- Mainstream credit providers may benefit to the extent that they have products which appeal to the same market serviced by fringe credit providers. This is because all interest, fees and charges will be dealt with in the same way if unconscionable. Credit providers who do not currently impose unconscionable interest, fees or charges will be able to compete more efficiently with those who impose unconscionable interest fees and charges.

Benefits to governments

- The Government would be seen to be preventing unjust conduct and the imposition of unconscionable interest, fees and charges in a consistent way in the consumer credit area.
- Costs incurred by Government consumer agencies in having interest, fees and charges declared unconscionable by a court could be recovered when ordered by a court.
- The Government would be seen to be providing a consistent approach in the Code to unconscionable interest, fees or charges in a way that will also address avoidance activity.
- The Code will not need to be constantly updated to keep pace with changes in the type of fees and charges imposed.

5.2.3. Preventing avoidance of the Code

5.2.3.1 Costs/disadvantages – preventing avoidance of the Code

Costs to fringe credit providers

- Removal of the BPD may result in costs as credit providers generally seek advice on alternative administrative arrangements for loans they consider to be outside the Code. Alternative arrangements may include extra training of staff and drafting of new forms to justify the classification of a loan as a business purposes loan.
- Without the certainty of a BPD, fringe credit providers may err on the side of caution rather than risk legal action and assume that the borrower is subject to the Code, particularly for car loans, resulting in increased ongoing compliance costs for credit providers to ensure Code compliance. Such costs may include external legal advice and time spent by employees in completing relevant Code forms.
- Some credit providers, brokers or linked suppliers may assert they do not have certainty about a consumer's status under the Code without a BPD and in the absence of the statutory BPD, may ask debtors to sign a BPD-style form, which will give them written proof of business purpose.
- Those credit providers who utilise exemptions in inappropriate cases may lose business to those credit providers who are Code compliant as consumers make informed choices (because of the Code's disclosure regime) and decide upon alternative arrangements.
- Fringe providers, who are currently avoiding the application of the Code, may now be subject to the Code and incur increased compliance costs including initial legal advice and training of employees as well as ongoing compliance costs.

Costs to borrowers

- It is possible some negative impacts could be felt by the passing on of initial and ongoing administrative costs (as identified above) to borrowers incurred

by lenders in complying with the Code amendments. It is uncertain how many credit providers will incur extra administrative costs, which may then be passed onto consumers.

Costs to mainstream credit providers

- The change to the BPD may result in initial upfront costs as credit providers make alternative administrative arrangements for loans for business purposes. Alternative arrangements may include extra training of staff and drafting of new forms. This would be an initial upfront cost however this is unlikely to be substantial as mainstream credit providers are likely to already have sufficient compliance systems in place and in any event, are unlikely to use BPDs unless the loan is genuinely for business purposes.
- Mainstream lenders may experience less certainty and a small proportion may err on the side of caution, rather than risk legal challenge and assume that the borrower is subject to the Code with the resultant administrative costs associated with Code compliance.
- There would be minimal costs to mainstream lenders as a result of removing the bill facility exemption as most commercial users of bill facilities would not be captured by the Code as the bill facility is not used for personal, domestic or household purposes.

Costs to pawnbrokers

- Under the proposal, if a pawnbroker took a mortgage as security, the pawnbroker would be required to comply with the Code. For these pawnbrokers this would mean initial administrative costs in developing systems to be Code compliant and ongoing compliance costs.

Costs to government

- There would be initial administration cost associated with amending the Code and educating both consumers and credit providers of the amendments.
- There would be additional enforcement costs to that noted for the status quo in ensuring that the new provisions are being complied with.

5.2.3.2 Benefits/advantages – preventing avoidance of the Code

Benefits to fringe credit providers

- Preventing rogue fringe credit providers from bypassing the Code could impact positively on the market's reputation and consumer confidence, leading to increased business.
- Those fringe credit providers who are Code compliant may gain business from credit providers who currently use exemptions because consumers are now better able to compare loans across the consumer credit market based on information disclosed under the Code.

Benefit to borrowers

- If the amendments were effective in preventing lenders from styling consumer credit arrangements to fall outside the ambit of the Code, consumers would be provided with disclosure and other protections and remedies under the Code that are not currently being provided to these borrowers.
- The benefit for consumers of removing BPDs would be that in circumstances where they are prevailed upon to sign, they unwittingly sign or they sign based on misleading information, they will have the opportunity to argue that the presumption in s.11(1) stands. They will not be hampered by a conclusive presumption.
- The disclosure requirements under the Code will help borrowers understand and compare loans which will lead to lenders competing with each other forcing prices down for consumers.
- The benefit to borrowers who previously had been given credit pursuant to a bill facility would include that payments are not accelerated to provide for full payment upon a default and debt collection practices abide by the Code's protective provisions including the requisite notice periods and rights in relation to repossession.

Benefits to mainstream credit providers

- Mainstream credit providers may benefit to the extent that they have products which appeal to the same market serviced by fringe credit providers as the Code's disclosure rules mean they will be able to compete on an equal footing with fringe credit products that do not currently comply with this regime.

Benefit to pawnbrokers

- If the pawnbroker's exemption was clarified it is possible the reputation of the pawnbroker's part of the fringe credit market would improve. This would impact positively on consumer confidence and consumer demand for fringe credit products.

5.2.1. Disclosure of Annual Percentage Rate - summary

Clarify that disclosure of an APR is required for all credit contracts	
Fringe credit providers	
Costs and Disadvantages	Benefits and Advantages
Costs incurred in determining the APR and amending loan documentation if required. Decrease in business if providing an APR prompts a borrower to obtain a loan at a more competitive rate or reduced profits, if forced to compete fairly.	May improve reputation of industry which could impact positively on consumer confidence and demand for fringe credit products.

Borrowers	
Costs and Disadvantages	Benefits and Advantages
Any additional costs incurred by lenders may be passed on to borrowers most likely through higher fees/charges.	Costs may decrease due to increased competition where the APR is used by all lenders to indicate cost of borrowing. Better choices may be made based on the information required to be disclosed in an APR.
Mainstream credit providers	
Costs and Disadvantages	Benefits and Advantages
No identified costs.	No identified advantages.
Governments	
Costs and Disadvantages	Benefits and Advantages
Cost to amend Code and ensure understanding of and compliance with new requirements. Additional compliance and enforcement costs, particularly in the short term.	Consistent with Code objectives that consumer credit should be covered by the Code. Further information may stop some borrowers getting into financial stress and reduce reliance on government services.

5.2.2. Extending application of existing remedies under the Code – summary

Extending application of existing remedies under the Code	
Fringe credit providers	
Costs and Disadvantages	Benefits and Advantages
Interest, fees and charges that may be unconscionable but not presently subject to challenge will be able to be reviewed resulting in loss of potential profits to providers. Greater likelihood of challenge to unjust contracts resulting in businesses facing increased risk of costs associated with legal action	Guidance may be given to appropriateness of fees and charges imposed by fringe credit providers. The reputation of the fringe credit market may improve and therefore demand may increase as consumers become more confident about the legitimacy of fringe credit products.
Borrowers	
Costs and Disadvantages	Benefits and Advantages
There may be some initial opportunity cost if regulation affects willingness of providers to offer innovative products.	Borrowers will be able to seek review of all, and not just a limited class, of interest, fees and charges which are unconscionable. A more realistic description of fees and charges may result as the incentive to

	<p>move profit and cost recovery away from the current specified fees and charges is removed.</p> <p>Borrowers with limited financial capacity may have a better chance of obtaining redress if government consumer agencies are permitted to make applications under s.70 and 72.</p>
Mainstream credit providers	
Costs and Disadvantages	Benefits and Advantages
<p>May be some costs if interest charges or fees are challenged as unconscionable if not previously able to be challenged.</p>	<p>Mainstream credit providers who do not include unjust terms or impose unconscionable fees/charges and interest will be able to compete more directly with fringe credit providers who impose such charges.</p>
Extending application of existing remedies under the Code	
Governments	
Costs and Disadvantages	Benefits and Advantages
<p>There may be pressure on governments to take action to assist consumers subject to unconscionable interest, fees and charges resulting in increased ongoing compliance and enforcement costs.</p>	<p>The Government would be providing a consistent approach in the Code to unjust transactions and unconscionable fees and charges.</p> <p>The Code will not need to be constantly updated to keep pace with changes in the type of fees and charges imposed.</p>

5.2.3. Preventing avoidance of the Code - summary

Preventing avoidance of the Code	
Fringe credit providers	
Costs and Disadvantages	Benefits and Advantages
<p>Costs incurred in restructuring arrangements to comply with the Code if loans were previously structured to avoid the application of the Code.</p> <p>Uncertainty as to whether a contract is subject to the Code may result in providers exercising caution and incurring increased compliance costs by deeming greater number of contracts to be bound by the Code.</p>	<p>May improve reputation of industry which could impact positively on consumer confidence and demand for fringe credit products.</p> <p>Those fringe credit providers who are Code compliant will be able to compete with those who currently avoid the Code, on an equal footing.</p>

Borrowers	
Costs and Disadvantages	Benefits and Advantages
There may be a minor increase in that proportion of providers that do not currently comply with the Code passing on administrative compliance costs to borrowers.	More borrowers would be provided with disclosure and other protections and remedies under the Code.
Mainstream credit providers	
Costs and Disadvantages	Benefits and Advantages
Initial upfront costs for alternative administrative arrangements.	Minor benefit where mainstream providers service same market as fringe providers, and can now compete on an equal footing.
Pawnbrokers	
Costs and Disadvantages	Benefits and Advantages
Costs incurred in complying with the Code where newly captured by the Code.	May improve reputation of industry which could impact positively on consumer confidence and demand.
Governments	
Costs and Disadvantages	Benefits and Advantages
<p>There would be initial administration cost associated with amending the Code and educating both consumers and credit providers of the amendments.</p> <p>There would be additional enforcement costs, particularly in the short term to ensure that the new provisions are being complied with.</p>	<p>Will improve consumer protection by helping to ensure all consumer credit products are regulated by the Code.</p> <p>Consistent with Code objectives that consumer credit should be covered by the Code.</p>

5.3 Greater Regulatory Intervention

5.3.1 Extra disclosure requirements

5.3.1.1 Costs/disadvantages – extra disclosure requirements

Cost to fringe credit providers – extra disclosure general

- The extra disclosure requirements would require a credit provider to calculate whether a loan comes within the definition of “high cost loan”. Loan offer documentation would need to be amended by, for example, including a comparison rate, statutory warning and information about cancelling direct debits. As loan offer documents typically have a number of variables such as loan amount to insert, it is not expected that the costs to include these disclosures would be significant provided there are adequate transitional

arrangements that allowed sufficient time for providers to produce amended documentation.

- It is possible some high cost credit providers may face a decrease in demand due to some consumers reassessing loans and possibly seeking out lower cost loans or other options, such as pawning/selling assets or will need to reduce interest rates and charges to maintain business, which could cause a corresponding loss of profits and at the margins, cause businesses to cease operations.

In addition to the above, the following costs would be specific to the identified disclosure measures:

Cost to fringe credit providers - comparison rates

- A small proportion of fringe credit providers may already have compliance systems in place to calculate comparison rates. For the remaining credit providers that have been relying only on standard comparison rate schedules, there would be initial compliance costs in buying relevant software equipment to calculate comparison rates together with any associated training of staff. Such costs while perhaps only amounting to a few thousand dollars could be considered quite substantial for a small business franchisee.
- The requirement to provide a comparison rate in the offer documentation may require minor amendment to the administrative systems for drawing up the loan documentation to make provision for the comparison rate where there is a high cost loan. There may also be some minor ongoing costs associated with this requirement including continuous staff training as to what a comparison rate is and when to include it on loan documentation.

Cost to fringe credit providers - direct debit authorities

- There would be a one-off administrative cost associated with amending documentation to include the proposed information or drawing this document up separately. These costs are unlikely to be significant as providers would not need to seek separate advice on its formulation and there would not be a need for extensive staff training.
- It is anticipated that fringe credit providers who misuse direct debit authorities would feel increased pressure to comply with the authorities or risk consumer complaints being made against them.
- If such complaints go to the fringe credit provider's bank, they may find that their bank may withdraw the direct debit facility arrangement due to continued misuse or complaints being made.

Costs to fringe credit providers - statutory warnings

- A warning required by the Code would require that loan documentation be changed with the associated administrative costs noted above.
- A statutory warning may result in a decrease in demand due with resulting loss of profit as some consumers reassess their need for the loan and possibly seeking out lower cost loans or other options. However this effect is likely to be small as a warning before the loan is provided is likely to result in little behavioural change among borrowers.

Costs to borrowers - extra disclosure general

The costs/disadvantages of the proposed extra disclosure requirements are similar across all three proposals and will not be repeated separately.

- Fringe credit providers may pass on any extra costs incurred as a result of extra disclosure requirements to borrowers.
- The protection provided by the extra disclosure will be limited to those loans above the high cost threshold. For example, those borrowers who are just below the threshold will not get the benefit of the protection proposed by the extra disclosure.

Costs to mainstream credit providers– extra disclosure general

- The proposed extra disclosure requirements may impact on mainstream credit providers, or their borrowers, as some fees and charges could bring the comparison rates of many credit products provided by “mainstream credit providers” to the proposed threshold. This small number of mainstream providers would then have the extra costs detailed above that fringe lenders would have in implementing the extra disclosure.
- Interest rate charges could also rise taking some financial products into the high cost loan category. This raises concerns about the arbitrary nature of using a percentage point to distinguish between “low cost” and “high cost” loans. Mainstream credit providers would then have the additional administrative costs in preparing documentation as detailed above for fringe credit providers however on a much larger scale.

Costs to governments - extra disclosure general

- There would be administration costs associated with amending the Code and educating both consumers and credit providers of any new disclosure provisions however these costs are unlikely to be greater than the costs detailed above for minimal regulatory intervention as the interventions proposed similarly rely mainly on legislative amendment. Depending on the method used to calculate a high cost loan, some minor additional costs may be incurred as a result of changes being made to any threshold so that it keeps pace with inflation and changes in interest rates.
- Enforcement costs may be initially higher to ensure the new provisions are being complied and some minor ongoing enforcements cost in ensuring that credit providers are disclosing the additional material.

5.3.1.2 Benefits/Advantages – extra disclosure requirements

Benefits to Fringe credit providers – extra disclosure general

- The extra disclosure requirements would provide consumers with more information. This may improve the reputation of the fringe credit market which could impact positively on consumer confidence and demand for fringe credit products. Any impact on reputation is however likely to be minor given that the extra disclosure reveals the loans to be high cost.

- Other than the minor benefit noted above, there would be little if any benefit for fringe providers under this proposal.

Benefits to Borrowers - comparison rates

- Research on consumer behaviour in the consumer credit market indicates that the vast majority of people compare interest rates between credit providers when deciding which credit provider to borrow from and a majority of consumers find it relatively easy to compare interest rates.⁵² For borrowers, extra disclosure requirements which specifically list the comparison rate in the offer documentation may result in the cost of borrowing money becoming more transparent and as fringe credit providers start directly competing with each other, there is a possibility that costs will decrease.
- The mandatory comparison rate requirements in the Code (*Consumer Credit Code (Queensland) Amendment Act 2002*) were introduced because consumers face a confusing array of interest rates and fees/charges. It is likely that as consumers become increasingly familiar about the use of comparison rates, they will find it relatively easy to compare comparison rates (like interest rates). The MCCA has stated that a full cost/benefit analysis of the new mandatory comparison rates requirements will be conducted in 2005. Therefore, at this stage it is not possible to provide evidence of the extent to which fringe credit borrowers would benefit from being provided with the comparison rate to use as a comparison tool. However, borrowers that did use it as a comparison tool would be likely to benefit because they would be able to select the lowest cost credit available to them.
- Even if borrowers did not benefit from using the comparison rate to compare loans, it would provide information to assist in deciding whether or not to accept a high cost loan offer. If the provider of a high cost loan is required to state the comparison rate, this would assist borrowers in their decision and may stop some borrowers from paying too much for credit.

Benefit to borrowers - statutory warnings

- Borrowers may also benefit from the statutory warning indicating the loan product is an expensive form of credit as it would draw borrowers' attention to the high cost of the loan. However, this may not assist borrowers with no alternatives.
- The cost of loans may drop as credit providers minimise the cost of their loans that are on the threshold of being classified as high cost loans to ensure they are below the threshold.

⁵² See 'Talking Credit – A Survey of Consumer Behaviour in the Australian Consumer Credit Market' Malbon, J., Law School, Griffith University, September 1999, and in particular 9.2.3, pages 58 to 60.

Benefits to borrowers - direct debits

- Borrowers would benefit from being provided with information that their direct debit authority can be cancelled at any time by contacting their bank, credit union, building society etc.
 - This information would inform borrowers that they may cancel such authorities if they are being misused by credit providers and may prevent them from incurring fees each time the credit provider accesses an account with insufficient funds.
 - Borrowers would also be told where to lodge a complaint if the authority is misused. This would increase pressure on fringe credit providers to comply; otherwise their own bank may withdraw their direct debit facility arrangement due to the number of complaints being made about their conduct.

Benefits to mainstream credit providers – extra disclosure general

- There are no particular benefits or advantages to mainstream lenders identified.

Benefits to governments – extra disclosure general

- In ensuring that consumers are given information needed to assess the true cost of the loan and to cancel a direct debit authority at any time the Government may prevent some borrowers from getting themselves into (possibly further) financial difficulty and thus having to access government or community support facilities.
- The Government would also be seen to ensure that consumers have available to them the most comprehensive financial information possible.

5.3.2. The prohibition on taking security over household goods and security for loans under \$3,000 by fringe credit providers

5.3.2.1 Costs/disadvantages – Prohibiting security over household goods and for loans under \$3,000

Costs to fringe credit providers – prohibiting security over household goods

- This proposal would only affect a small proportion of fringe credit providers, as the majority of fringe credit providers offer unsecured loans or do not take security over household goods. For example, payday loans are typically unsecured and some micro-loans are unsecured.
- Fringe credit providers who take security over essential household property would no longer be able to do so. Some borrowers may be able to offer other goods (non-essential household goods) as security if required. However, it is likely some borrowers will not have other goods to offer. This could result in three impacts for fringe credit providers.
 - Business may be reduced if some borrowers are not able to obtain a loan due to the security requirement.

- The fringe credit provider may change their requirements and offer loans without taking security. This could effectively increase the number of borrowers eligible for loans - however this could increase the risks associated with lending money and may result in more defaults. Some fringe credit providers may decide to discontinue operating or may increase the cost of credit to reflect the increased risks, rather than the security reflecting the value of the loan.
- Additional costs may include a need to spend more time undertaking credit checks if loans have potential security removed by regulation.
- It is also possible recovery costs may increase without such security. However, essential household goods are typically of low value and their repossession may not assist in recovering outstanding loans. Security over household goods is primarily taken to provide a fear of repossession on failure to repay.
- The conduct of some fringe credit providers who demand security over household goods and threaten repossession of these goods has contributed to the bad reputation of fringe credit providers and justification for classifying lenders who demand such securities as existing on the “fringe” of the credit market. Household goods are generally considered a necessity of life therefore the repossession of these goods is considered unfair by community standards.

Costs to fringe credit providers – prohibiting any security for loans under \$3,000

- Many fringe credit providers primarily provide loans with a principal of \$3,000 or less. A proportion of fringe providers takes security for such loans, including cars and other valuable items and would be affected by this proposal. However, the majority of loans are unsecured such as payday loans.
- This proposal would have a greater impact on a larger number of fringe providers than the above proposal with respect to household goods.
- If the proposal was put in place, the vast majority of such loans would be unsecured with the result that fringe credit providers may:
 - cease lending completely because of the high risks involved – as a result there would be costs of closing the business, such as redundancy payments, lease payout, etc;
 - restrict the maximum amount of loans provided to reduce risk – likely reducing business profitability;
 - tighten lending criteria to reduce risk, which would be likely to reduce the size of the market; and
 - increase interest charges commensurate with the unsecured risk – reducing the likely market.

Costs to borrowers - prohibiting taking security over household goods

- Those borrowers who access fringe credit loans may find it more difficult to obtain a loan if they only have household goods to offer as security and are high risk, however this proposal would not generally affect borrowers of payday loans. Those borrowers affected may be unable to access credit at all

or they may be forced to obtain unsecured credit. Unsecured loans are currently offered by some fringe credit providers in some circumstances. For example, payday loans are typically unsecured and some micro loans are unsecured.

- Secured credit is generally cheaper because less risk is attached. Removing the ability to take security over household goods would reduce the market for fringe credit loans at current prices. If borrowers were unable to offer other security they would face an increase in the price of credit due to the higher risk incurred in obtaining unsecured credit.
- This option could also impact on borrowers if lenders selling household goods on credit are not able to take security over the household goods being purchased. This would make it more difficult to purchase such items on credit.

Costs to borrowers - prohibiting taking security for loans under \$3000

- This option would impact on a larger number of borrowers as it includes all forms of security, not just household goods. Therefore, a larger number of borrowers may be affected, both in terms of increased interest rates and fees and charges to compensate for the increased risk of lending to an unsecured section of the market.
- Prohibiting the taking of all forms of security for loans under \$3000 would further reduce the market for loans available at current prices to borrowers. Whether new entrants would satisfy this demand is uncertain as there is insufficient information to determine. However, it does appear likely that there will be some rise in the price of fringe credit loans at the lower end of the market. It is unlikely that there will be a long term impact on competition as there should still be a relatively large number of providers and prices will be set at competitive rates.
- The threshold of \$3,000 may be considered arbitrary, especially for those who borrow slightly more than that amount. It may be preferable that whatever amount is set be indexed to take into account inflation.

Costs to mainstream credit providers - prohibiting taking security for loans over household goods & prohibiting security for loans under \$3000

- There is unlikely to be a significant impact on mainstream credit providers, as there is little evidence of mainstream credit providers demanding security over household goods or requiring security for loans under \$3,000.
- This proposal may impact on credit providers that offer loans or hire/purchase for the purchase of new household goods. These loans use security over the goods being purchased. Removing the ability to take security over household goods would mean that these credit providers can no longer enter into these arrangements.
- Prohibiting the taking of certain securities for loans under \$3,000, by itself, may not address the problem as individual circumstances should be taken into account when deciding to lend money. Whilst mainstream credit providers such as banks may not, as a general rule, obtain security over household goods there is no reason why this could not change in the future and may impose

restrictions on product design and thus undercut the objective of product flexibility underpinning the Code.

Costs to governments - prohibiting taking security for loans over household goods & prohibiting security for loans under \$3000

- There would be administration costs associated with amending the Code and educating both consumers and credit providers about new disclosure provisions. These costs are unlikely to be significantly higher than that noted above for minimum intervention as they are likely to form part of the same education and awareness campaign.
- Enforcement costs would not be significantly above those costs detailed above for minimal regulatory intervention as these costs are likely to centre around some ongoing compliance monitoring, particularly in the short term.
- Prohibitions may mean a proportion of finance available at current prices may be lost to borrowers, leading to potential for greater pressure on government resources such as the provision of social assistance.
- There is little research into the impact that removing securities would have on borrowers in the fringe market and consequently on Government. What evidence there is, is anecdotal, and suggests that fringe providers will still provide loans however at higher cost. The risk of the proportion of borrowers unable to access this higher cost credit and resorting to crime to access cash would be relatively small. There is greater likelihood that these borrowers would resort to family members, community organisations and Centrelink Advances.
- For those consumers that are already entitled to access Government benefits, it is likely that they would already be in receipt of such payments thereby not increasing costs to Government. Centrelink offers Centrelink Advances which is the once a year provision of approximately \$500 which is then subsequently repaid over the next 6 months. It is possible that there may be greater demand for these payments however there is no additional cost to Government as they are repaid.

5.3.2.2 Benefits/advantages - Prohibiting taking security over household goods and taking security for loans under \$3,000

Benefits to fringe credit providers – prohibiting security over household goods

- Many payday loans and a proportion of micro loans are not secured, so restricting security may have little adverse effect on these loans.
- The conduct of some fringe credit providers who demand security over household goods and threaten repossession of these goods has contributed to the bad reputation of fringe credit providers. The proposal to prohibit this conduct may improve the reputation of the fringe market. However any positive impact is likely to have small impact.
- An improvement in the reputation of the fringe industry would impact positively on consumer confidence and consumer demand for fringe credit products. Fringe credit providers would benefit from the improved reputation and consequential increased business.

Benefits to fringe credit providers – prohibiting security for loans under \$3,000

- This proposal may improve the reputation of fringe credit providers as they would not be seen to be taking security over items that are essential to the borrower and provide little recovery value to the credit provider.

Benefits to borrowers - prohibiting taking security over household goods

- The benefit to borrowers is that their essential household goods would be immune from repossession.
- The threat of repossession of household goods may be considered disproportionate having regard to the relatively small amounts likely to be outstanding on a fringe credit loan. Prohibiting household goods from being used as security will prevent a compounding of the financial difficulties which may have led borrowers to enter into a high-cost credit arrangement in the first place.
- Harmonisation of laws relating to household goods at State and Commonwealth level will create certainty for borrowers about their rights in relation to repossession.

Benefits to borrowers – prohibiting security for loans under \$3000

- An advantage of prohibiting the taking of securities would be that in the event of default, all lenders would have to use the small debts court process which would provide protection to the borrower by way of review of the contract because, for example, it is unconscionable or beyond the provisions of the Code.
- Prohibiting any type of security for a loan under \$3000 may prevent repossession of a vehicle used to secure a loan under that amount. Given that for some borrowers their vehicle is essential for travel, prohibiting the taking of vehicles as security would prevent the dislocation caused by the loss of a vehicle in the event of default.

Benefits to mainstream credit providers - prohibition on securities - general

- It is possible some mainstream credit providers may be advantaged if the reputation of the fringe credit market improves leading to more demand. Currently, there is some pressure on mainstream credit providers from Commonwealth and State levels to provide low-cost credit to vulnerable consumers who may have been disadvantaged in the past by obtaining credit from fringe credit providers. Any improvement in the reputation of the fringe lending industry may reduce pressure on some mainstream credit providers who do not wish to service this segment of the market. However, this benefit is relatively minor and would not extend to all mainstream credit providers.

Benefits to governments – prohibition on securities – general

- The government would be prohibiting a practice considered unfair by the community, due to its creation of additional hardship and emotional distress

when consumers are threatened with forfeiture of items considered to be essential.

- Another benefit would be to have harmonisation of legislative requirements regarding repossession with regards to bankruptcy regulations and debt recovery. Harmonisation of these laws will create regulatory efficiency between debt collection practices at a Commonwealth and State level and allow sharing of information thereby reducing administrative costs.
- A further advantage for governments is that third party impacts would be reduced. These impacts relate to the demand on community and government services when consumers are faced with repossession. For example, the repossession of household goods could lead consumers into crisis or financial counselling. These consumers may need help from government agencies or from community service providers.

5.3.1. Extra Disclosure Requirements for High Cost Loans - Summary

Extra disclosure requirements for high cost loans	
Fringe credit providers	
Costs and Disadvantages	Benefits and Advantages
Some costs incurred in amending loan documentation and in calculating individual comparison rates. Possible decreased demand due to consumers seeking alternatives.	May improve reputation of industry which could impact positively on consumer confidence and demand for fringe credit products.
Borrowers	
Costs and Disadvantages	Benefits and Advantages
Costs incurred by lenders may be passed on to borrowers. Failure by lenders to disclose as required will make loans seem more affordable. Minor cost as this is already the case.	Comparison rates would help borrowers identify the most affordable credit available to them. As the cost of borrowing money becomes more apparent, lenders may compete more vigorously with each other, forcing prices down. Direct debit information would assist borrowers to cancel an authority if it is being misused and may discourage misuse of direct debit authorities in the first place.
Mainstream credit providers	
Costs and Disadvantages	Benefits and Advantages
Changes in interest rates may bring some mainstream credit products into the “high cost” loan category. Credit providers may then incur costs related to amending documentation to provide for high cost loan information.	None identified.

Governments	
Costs and Disadvantages	Benefits and Advantages
Cost to amend Code and ensure understanding of and compliance with new requirements. These costs would be particularly relevant in the short term.	Further information may stop some borrowers getting into financial stress and reduce reliance on government services.

5.3.2 Taking of security by Fringe Credit Providers - summary

Fringe credit providers	
A prohibition on taking security over household goods	
Costs and Disadvantages	Benefits and Advantages
<p>Those fringe credit providers who take household goods as security may not be able to offer loans to borrowers who could only offer household goods as security. This would reduce the size of the market or require credit providers to offer such borrowers unsecured loans, possibly resulting in more defaults.</p> <p>A prohibition would require fringe credit providers to ensure the borrower was able to meet the terms of their loan without providing essential household goods as security. Such costs would include spending greater time undertaking credit checks.</p>	<p>Prohibiting the taking of essential household goods as security for such loans may improve the reputation of the fringe credit industry, thus increasing the number of potential customers.</p>
Security for loans under \$3000	
Costs and Disadvantages	Benefits and Advantages
<p>As many loans are for principal amounts of \$3,000 or less, loans would then be unsecured. This may impact on those businesses which will have to change lending practices to account for the increase in risk.</p> <p>Restricting maximum loans to low amounts may reduce business profitability or result in higher priced loans, leading to a reduced market.</p> <p>Tightening lending criteria to reduce risk may reduce the size of the market.</p>	<p>Prohibiting the taking of security for such loans may improve the reputation of the fringe credit industry, thus increasing the number of potential customers.</p>

Borrowers	
A prohibition on taking security over household goods	
Costs and Disadvantages	Benefits and Advantages
<p>There may be a negative impact on some fringe credit borrowers who may face higher transaction costs in locating fringe credit providers who do not require security for short-term loans or who may be denied access to such loans.</p> <p>May reduce the availability of credit for consumers to buy essential household goods.</p>	<p>A prohibition would remove the threat of repossession of essential household goods.</p>
Security for loans under \$3000	
Costs and Disadvantages	Benefits and Advantages
<p>Possible risk of increased interest rates and fees and charges to compensate for increased risk.</p> <p>May reduce the market for loans under \$3000 available at current prices.</p> <p>Threshold of \$3000 may be considered arbitrary, particularly for those who borrow slightly more than this amount.</p>	<p>Would eliminate the threat of repossession on items such as low-value cars.</p> <p>Would require lenders to use the small debts court process which would provide protection to the borrower by way of review of the credit contract if, for example, the contract is unconscionable, or beyond the provisions of the Code.</p>

A prohibition on taking security over household goods and security for loans under \$3000	
Mainstream credit providers	
Costs and Disadvantages	Benefits and Advantages
<p>Would prevent loans to purchase household goods being secured on the item purchased.</p> <p>May restrict product design to some extent.</p> <p>Is unlikely to impact significantly on this market.</p>	<p>To the limited extent that this proposal may improve the reputation of the fringe credit market this may lead to more demand in that sector and reduce the pressure on those mainstream credit providers who may not wish to service this segment of the market but feel compelled to.</p>
Governments	
Costs and Disadvantages	Benefits and Advantages
<p>Administration costs associated with amending the Code and educating consumers and credit providers about any prohibition.</p> <p>Increased enforcement costs</p>	<p>Harmonisation of legislative requirements regarding repossession of essential household goods with Commonwealth bankruptcy legislation.</p> <p>Demand on community and Government</p>

<p>associated with ensuring that fringe credit providers comply with the prohibition, particularly in the short term.</p> <p>If a prohibition results in a proportion of finance currently available to borrowers being lost, this may lead to greater pressure on government subsidised services such as the provision of social assistance.</p>	<p>agencies for assistance may be reduced if credit providers are not allowed to take security over household goods.</p> <p>Government would be prohibiting a practice considered unfair by community standards.</p>
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6. Consultation

This part of the RIS/PBT outlines who has been consulted, and provides a summary of the feedback provided during consultation by those representing major groups who will be affected by the proposed action.

The Discussion Paper was released for public comment on 3 September 2003. The closing date for submissions was 10 October 2003.

Thirty-eight responses to the Discussion Paper were received. The responses have been analysed and the cost-benefit analysis has been enhanced to reflect information gained through consultation. The stakeholders who submitted responses are listed at Appendix 2.

It should be noted that the proposed regulatory options to address the problems in the fringe credit market in this RIS/PBT have been modified based on the feedback provided during consultation on the Discussion Paper. In particular, the proposed amendments to the pawnbroker exemption have been modified to make clear the exemption given to pawnbrokers in the Code is limited to the activities rightly classified as pawnbroking activities and the proposed restriction on the exemption provided for bill facilities and BPDs has been included. Consultation feedback has also resulted in the proposed extended application of existing remedies under ss.70 and 72 of the Code. A further opportunity to consult on any proposed amendments and in particular, on those not included in the Discussion Paper, will be provided when any draft amendments are released for consultation.

6.1 Consultation feedback - general

6.1.1. Further regulation of the fringe credit market leading to a rise in “loan sharks”

Several stakeholders commented that some regulatory actions (including, for example, capping interest rates or fees and charges) may compromise the ability of fringe credit providers to operate profitably and would be “throwing low income consumers to the loan sharks”. However, in a Canadian study that included a survey of payday borrowers, it was found that there was not a great deal of evidence to support the

proposition that people would turn to more extreme forms of lending if payday loans (the type of loan under consideration in that study) were prohibited.

None of the survey respondents in that study indicated they would use loan sharks instead of fringe credit providers if they were unable to access credit from payday lenders. The study noted this was not surprising, given that few people would admit to contemplating an illegal act and loan sharking was seen as something used by gamblers or drug addicts.⁵³ However, the survey results support the idea that people are not acquainted with loan sharks, and would not know how to contact one. Instead, the most common alternative indicated in the survey was obtaining money from family and friends. Turning to mainstream financial institutions, such as a bank or trust company, was the next highest alternative choice.⁵⁴

The study discussed that if people could not obtain finance readily, they may have to do without this source of funds, as people undoubtedly did before the introduction of payday loans.

6.1.2. Consultation feedback - information asymmetry and affordable credit

In general, stakeholders disagreed with the contention in the Discussion Paper that the main problem relevant to the fringe credit market was information asymmetry. Some mainstream lenders commented that asymmetry of all types is a fact of life. No amount of disclosure or warning will completely correct it.

It was also argued the problem is not lack of information but the need for short term credit. Some stakeholders argued that financial counselling clients are increasingly using credit to make up for lack of income required to deal with life emergencies and purchase basic necessities.

Related to this, many stakeholders were of the view that the problem was the lack of affordable credit on reasonable terms available to low income earners. It was suggested that once a borrower became unable to access credit from mainstream lenders, providing these borrowers with additional information about the high cost of their loan would not make their need to obtain credit go away.

A submission by Griffith University Law School argued that mainstream credit providers need to be enticed into the market to provide real competition and choice for consumers. It was suggested that consideration could be given to a model such as that adopted in the USA under the *Community Reinvestment Act 1977*. This Act requires periodic evaluation of performance of mainstream credit providers in meeting the credit needs of their communities, including the needs of low and moderate-income consumers. That record is taken into account in considering an institution's application for deposit facilities, proposed mergers and acquisitions.

⁵³ “*Fringe lending and ‘Alternative’ Banking: The Consumer Experience*” Lott. S and Grant. M, Public Interest Advocacy Centre with Funding from Industry Canada, page 113.

⁵⁴ “*Fringe lending and ‘Alternative’ Banking: The Consumer Experience*” Lott. S and Grant. M, Public Interest Advocacy Centre with Funding from Industry Canada, page 53.

Consumer protection agencies agree that while truth in lending remains a valuable foundation for the Code, experience has found this is not sufficient by itself, as some lenders will structure loan costs and interest payable to make it difficult for consumers to compare loans. It was also argued that low income consumers have been increasingly shut out of the mainstream credit market and that because of the pressing need for credit felt by some consumers, competition does not operate effectively in the fringe credit market - therefore, disclosure is not the way to address problems in this market.

6.2 Consultation feedback on the proposals

6.2.1. Retaining the status quo

The Discussion Paper argued the costs of continuing the status quo outweigh the benefits to the community as a whole and readers were asked whether they agreed with this contention. Overall, the feedback provided agreed with this proposition.

Several submissions noted that further compliance activity by regulators could address these problems. It was also argued that there were already sufficient remedies in the Code to assist consumers.

However, while agreeing the status quo is not sufficient to regulate the fringe credit industry, some fringe credit providers considered the industry should have its own Code of Conduct and not be forced to use a Code not suited to the credit products it offers. Some micro lenders disagreed that the status quo results in a net cost to the community other than in the sense that borrowers have to pay the price set by the market.

6.2.2. Clarify that disclosure of an APR is required for all credit contracts

Stakeholder responses provided during consultation on the Discussion Paper indicated many fringe credit providers currently disclose an APR although there is said to be widespread inconsistency.

Some fringe credit providers argue that an interest rate is not used as a method of calculating their return because loans are of such a short duration, an APR is irrelevant and would not assist consumers. However, a number of other fringe credit providers currently disclose to consumers both a monthly interest rate and an APR.

Some payday lenders considered compliance costs would be substantial and put them out of business and push disadvantaged consumers into illegal borrowing practices. On the other hand, some micro lenders were of the view that costs would be minimal.

Consumer protection agencies added that an APR is meaningless unless a comparison rate is also provided including all fees and charges. It was also argued the anticipated benefits for borrowers will not eventuate without:

- defining “fees” to mean only reimbursement of costs;
- including all broker fees (payable to any third parties) in the comparison figures;

- including “pawnbrokers” dealings into the comparison figures;
- broadening the definition to include the activities of firms that, on paper, buy goods from the customer and then rent them back to the customer;
- including insurance commissions from the credit provider’s directive; and
- altering the comparative interest rate approach to a simple “price tag” approach.

Consumer submissions were contrary to the suggestion by some fringe credit providers that an APR or comparison rate is irrelevant for loans of short duration. Consumer groups argued that although many fringe credit loans present as being of short duration they end up being much longer as they are rolled over, renewed or extended.

Consumer groups also say borrowers are able to understand and use APRs and knowing what the APR is on a loan helps borrowers to choose the most appropriate loan. Providing greater choice in the market was again identified as a way to address market failure and enhance consumer protection.

Mainstream credit providers stated that if it is proposed that all credit fees and charges for all credit providers should be converted to an APR and added to the APR and expressed as the total APR there would not be support for that proposal. The Code draws a clear distinction between “interest” on the one hand and “credit fees and charges” on the other. Each is required to be disclosed separately under the credit contract. This would be a fundamental change to the Code that will necessitate substantial documentary changes, computer system enhancements and internal instructions within banks.

Concern was expressed that an APR as currently determined by the Code does not give an accurate picture of interest actually paid for a loan by a fringe credit provider because loans can be as short as one week for a payday loan. For longer terms an annual figure is an easy denominator. For a payday lender who lends \$100 with a repayment of \$120 in 7 days – if calculated in accordance with the Code this equates to an APR of 1,040%. The rate seems exorbitant but the lender is making \$20 gross profit (20%) and netting significantly less. The perception the APR gives is incorrect. Fringe credit providers argued that the total interest paid in the year is \$20, therefore, the disclosed percentage rate should be 20%.

It was generally agreed during consultation that a charge which is truly in the nature of interest should be disclosed as an APR. However, some credit providers argued that it is not certain how this can be made clearer without detailed prescription relating to fees and charges or the introduction of a pre-determined credit charge concept which does not fit with the policy objectives of the Code including product flexibility and which could affect all credit providers - not just those engaged in unfair behaviour. It was argued that it was preferable to rely on judicial determinations and enforcement by government agencies of the existing requirement in s.15C of the Code to disclose an APR plus fees and charges.

6.2.3. Prevent fringe credit providers from avoiding the application of the Code

6.2.3(a). Pawnbroker arrangements

The proposal to address the pawnbrokers exemption contained in the Discussion Paper was that the Code not apply to the provision of credit in the ordinary course of a pawnbroker's business where the amount of credit is less than the reasonable market value of any security provided for that credit.

Consultation feedback on that proposal indicated stakeholders were unsure how effective the proposal would be in achieving the government's objectives. There was some agreement that determining the market value of pawned goods would be unworkable as the true market value can only be determined when goods are sold in a competitive environment. Otherwise the cost of implementing such an amendment would be prohibitive.

Consultation also revealed that in NSW a pawnbroker is limited to recovering the sale proceeds of pawned goods where the goods are not redeemed. The pawnbroker must take possession of the pawned goods. Pawnbrokers have an excellent idea of what pawned goods are worth and never intentionally lend more than their value. It was stated the amount advanced is more likely to be one-tenth of the value of the goods. As long as the pawnbroker takes "actual possession" of the goods, there is a real difference between pawnbroking and other credit transactions.

Consumer protection agencies stated that forcing pawnbrokers to obtain independent valuations of pawned goods as proposed in the Discussion Paper would be an unnecessary expense. They stated genuine pawnbrokers would have no difficulty in establishing that pawned goods were worth more than the money advanced, and as long as they were not required to actually pay for someone to value the goods, it would be business as usual.

6.2.3(b). Use of broker/credit provider arrangements

Consumer protection agencies stated the Discussion Paper appears to assume that the primary problem in respect of finance brokers is additional or excessive fees. In fact one of the primary problems is that the involvement of a finance broker or other intermediary creates a barrier between the borrower and lender that can facilitate avoidance of the Code, particularly where a BPD is used.

Consumer protection agencies stated that the use of broker/credit provider arrangements is growing fast. They believe there is an urgent need to control the use of "brokers" who may charge exorbitant fees for doing very little. Where brokers have any sort of relationship with the credit provider, they should be deemed to be the agents of the credit provider and their fees and commissions should be added to the credit provider's disclosed fees and charges.

6.2.3(c). Business Purposes Declarations (BPDs)

Submissions noted that by requiring a borrower to sign a BPD, lenders create a presumption that the Code does not apply.⁵⁵ While a debtor can seek to rebut this presumption, this shifting of the burden of proof is sufficient to deny debtors the rights and remedies to which they are otherwise entitled under the Code. Further, if the lender utilises an intermediary to obtain the BPD (such as a solicitor), then even if the BPD is found to be ineffective, the lender's "belief" as to the purpose for which the credit was obtained is likely to ensure that the loan will be considered unregulated.⁵⁶

It was suggested that many transactions taking place within car yards involve a BPD. As an example of a high interest rate lender abusing BPDs, the case of *State of Queensland v. Ward and Anor*⁵⁷ was offered.

6.2.3(d). Bill facilities exemption

Submissions identified the issue of loopholes being used by credit providers to circumvent the Code. Specific reference was made to the exploitation of the bill facility exemption. Stakeholders have suggested that, where possible, loopholes such as the bill facilities exemption should be addressed as a matter of priority.

This is seen as being in the interests of both consumers and industry. The point was made that fringe credit providers currently complying with the Code are at a disadvantage in comparison to those credit providers exploiting the bill facility exemption. Closing this loophole may be a means of creating a level playing field and encouraging competition.

Since the initial consultation, WA has noted a substantial increase in the number of fringe providers that are relying on the bill facilities exemption to avoid the application of the Code.

6.2.4. Extending application of existing remedies under the Code

In general terms, mainstream lenders were concerned that proposals to address unfair and unjust conduct not capture mainstream lenders as they are already subject to a comprehensive legislative and regulatory environment. Some other stakeholders considered that any amendments to the Code should apply to all lenders, not just fringe credit providers.

⁵⁵ Consumer Credit Code – section 11.

⁵⁶ Eg. *Neuendorf v Rengay Nominees P/L & Anor*, (unreported) Victorian Civil and Administrative Tribunal, 3 September 2002.

⁵⁷ [2002] QSC 171

Consumer protection agencies thought redress mechanisms in the Code needed to be strengthened, together with a greater commitment by governments to enforce the Code and prosecute fringe credit providers who break the law or behave unconscionably.

In the cases of *individually* excessive or unconscionable fees, charges and interest, s.72 is of little assistance – as the unconscionable charges are spread over interest and fees. In this sense, the protections offered by ss.70 and 72 of the Code actually provide little assistance to individual consumers, and no protection at a systemic level. It was also noted that s.72 is limited in its operation to specific types of fees, which creates a clear incentive to lenders to spread the high cost of their loans across a range of fees, each of which becomes in isolation far more difficult to challenge.

Establishment fees and charges are also inflated by referring some of the cost to fees paid by the credit provider to brokers or other intermediaries.

Consultation revealed that some cases against fringe credit providers have been brought pursuant to s.70 of the Code and all such cases have settled, and the actions have had no impact on the activities of the relevant fringe credit provider. For example, the Victorian Consumer Credit Legal Service Inc. (VCCLS) has commenced a number of proceedings in the Victorian Consumer Affairs Tribunal against the same fringe credit provider and in relation to the same issues pursuant to s.70 of the Code, all of which have settled. While this has benefited those individuals on whose behalf VCCLS acted, it has not brought about systemic change, and will not assist the vast majority of consumers who have obtained credit from that fringe credit provider. It was claimed the costs of such intervention clearly outweigh the benefits, and do not provide consumers with the protections they require.

Another submission argued that consideration should be given to adopting a legislative response providing for an administrative body to be responsible for pursuing applications in relation to unjust or unconscionable terms on behalf of borrowers, as the borrowers are unlikely to bring these applications themselves.

Some fringe credit providers were of the view that there are already sufficient mechanisms to address unfair and unjust conduct within the Code and that government intervention should be limited to eliminating identified loopholes and enforcing the Code as currently expressed.

6.2.5. Extra disclosure requirements for “high cost loans”

6.2.5(a). Extra disclosure - general

Overall stakeholder responses indicated the extra disclosure proposals would not be effective in achieving the government’s objectives. There was some support for extra disclosure requirements on the basis they would ensure greater consumer information before completion of a loan but it was not considered that enhanced disclosure is the appropriate mechanism to provide consumer protection.

Mainstream lenders were of the view that the benefits of warnings and comparison rates are overstated as borrowers will most often not be in a position to make choices

about their borrowings. However, information about cancelling direct debits is of use and they agree with any decision to publicise that right.

It was also considered that a special statutory warning for high cost loans would be ineffective. Consultation indicated that a fundamental problem confronting borrowers is a lack of choice in accessing credit. Warnings are unlikely to affect change in people who cannot access credit elsewhere.

It was also noted that the most vulnerable fringe credit consumers have the lowest levels of financial literacy and are less able to identify and evaluate which credit products are the most suitable for them. Greater information disclosure will not assist low income consumers if they are unable to understand or use that information.

6.2.5(b). Extra disclosure - the formula used to determine a “high cost loan”

Some stakeholders did not agree with either definition proposed in the Discussion Paper as there would always be an element of artificiality about the cut off point for a “high cost loan”.

It was noted there are no distinctions in the mainstream market between different loans and it was queried why a high cost loan should be identified in the fringe credit market. By way of comparison, it was stated that credit cards are not defined as high cost loans when in fact some are capable of being very high cost.

Micro lenders stated that for ease of use and certainty, they would prefer the definition to be tied to a set rate. If so, there should also be an easy mechanism for reviewing the set rate.

Consumer protection agencies argued for a set rate, notwithstanding this does not track the cost of money. A variable definition is likely to be sufficiently uncertain as to undermine compliance, which will materially compromise the protection of borrowers.

Others stated it would be more appropriate for high cost loans to be set at the Bank Accepted Bill (BAB) rate rather than a fixed comparison rate as the BAB regime allows more recognition of changing conditions in the market.

Some mainstream lenders stated it was not correct for the Discussion Paper to state that it is unlikely that the extra disclosure requirements would impact on mainstream credit providers, or their borrowers, as they are unlikely to be offering “high cost” loans. This does not factor in credit fees and charges which could bring the comparison rates of many credit products provided by “mainstream credit providers” to the suggested threshold. Other mainstream lenders were not convinced that either of the proposed definitions for “high cost” is appropriate. Specifically:

1. Where the comparison rate is greater than the 90-day Bank Accepted Bill rate plus 25%. According to today’s BAB, this would mean any comparison rate higher than 30% (the current BAB is 5%, plus 25%) would be classified as high cost.
2. In the current interest rate environment 30% may be deemed to be a reasonable rate, however, it must be recognised that interest rates are at a historically low

level. Should interest rates rise, even marginally, many more products would be brought under the “high cost” classification.

6.2.5(c). Extra disclosure - comparison rate for loan offer

There was some support for the disclosure of a comparison rate for a particular loan as it was thought to be of assistance to consumers who have difficulty understanding the cost of credit.

Consumer protection agencies support the disclosure of a comparison rate, with the proviso that it be prominently displayed and argued all lenders should be required to provide a comparison rate. However, while an interest rate may be a large determining factor for a home loan of several thousand dollars the social demographic of customers for the non-mainstream market have little or no concept of what a difference in interest rates really means. Rather, they understand how many dollars per week they can afford, or how much the loan will cost them.

6.2.5(d). Extra disclosure - high cost loan warning

It was generally believed that a special warning for high cost loans would be ineffective.

6.2.5(e). Extra disclosure - direct debit authorities

In relation to direct debit authorities consultation revealed that there have been reforms in bank practice by the Code of Banking Practice 2003. The Rules of the Australian Payments Clearing Association (APCA) permit a customer to initiate a process for cancellation of a direct debit authority or a complaint about an unauthorised debit. The Code of Banking Practice 2003 (Clause 19) reinforces APCA’s rules in this respect.

Stakeholders noted that any information concerning direct debit authorities should refer to other financial institutions besides “banks” as not all borrowers have relationships with banks. Stakeholders also noted that a direction to contact the BFSO to resolve a dispute is not appropriate as the various segments of the financial services industry each subscribe to an independent dispute resolution scheme. It was suggested that reference to the ASIC register (which provides names of all registered dispute resolution schemes) may be an appropriate alternative to a direction to contact the BFSO.

Some lenders agreed information about cancelling direct debits is of use and agreed with any decision to publicise that right.

6.2.6. Amending the Code to introduce a prohibition on taking security over household goods, alternatively, a prohibition on taking security for loans under \$3000

Feedback indicated that a prohibition on bills of sale over household goods would be effective in ensuring borrowers’ household assets are protected. However, some unintended consequences were identified by several respondents, for example, an

outright prohibition would severely inhibit the operations of lenders offering loans or hire/purchase for the purchase of new household goods. These loans use security over the goods being purchased. It was argued that denial of security would adversely affect this large industry and greatly harm its consumers. As an alternative, it was suggested there should be a prohibition on taking security over household goods unless the credit is for the purpose of buying the secured item.

Some fringe credit providers argue the pricing structure and taking security over household goods reflects the risk and cost incurred in supplying low value, high risk loans to consumers over relatively short periods of time.

Consumer advocates said cars are essential items that should be immune from repossession. It was also reported that some borrowers are so distressed at the prospect of losing their household goods they seek medical attention for stress related disorders. Anecdotal reports include that a borrower committed a crime to obtain money to avoid the threatened seizure of household goods.

Some stakeholders agreed that if there was a prohibition on taking security over essential household goods, this could be achieved by linking to the list of goods immune from creditors provided in s. 6.03 of the Commonwealth *Bankruptcy Regulations 1996*.

6.2.7. Prohibition on security for loans under \$3,000

Many stakeholders did not think there should be a prohibition on taking any form of security for loans under \$3,000. However, there was support for the proposal from consumer groups.

It was reported that the vast majority of micro lenders and payday lenders lend amounts of less than \$3,000. To prohibit any security would mean the whole industry would only be able to give unsecured loans.

One micro lender suggested that the cut-off point should be \$1,000 arguing that this would deny credit to people with little hope of repaying their loan and deny unscrupulous lenders the opportunity to exploit the borrower by undervaluing security provided.

6.2.8. Interest rate caps

The decision to introduce an interest rate cap, and the level at which the cap is set, is presently a matter for each State and Territory. The following comments were made in response to release of the Discussion Paper:

- The cost for credit should be able to exceed interest rate caps as these do not allow sufficient financial returns for service offered.
- Setting interest rate caps on short term loans effectively removes the availability of short term credit and encourages operators who avoid the Code and employ unscrupulous methods of enforcement. An interest rate cap of 48% equates to 4% per month, which will not satisfy fringe lenders taking on a high risk for a short period of time.

- Interest rates on fringe loans could be capped at a level that would allow lenders to stay in business while not aggressively exploiting their borrowers.
- The only effective means of preventing continued exploitation is through a cap on credit. An interest rate cap presents the lowest cost-to-government mechanism (other than retaining the status quo). There should be a uniform interest rate cap of 48% on consumer lending which requires interest charges and all fees and charges to be included to calculate the maximum APR.
- The proposal to provide for an interest rate cap which includes all fees and charges would fundamentally change the ability of credit providers to cost recover as enshrined in the Code. An interest rate cap of 48% (however calculated) would make loans unprofitable.
- The policy foundations of the Code include avoidance of price control. A proposal to uniformly introduce an interest rate cap would change this fundamental of the Code.
- Do not agree it is fair or reasonable to consider a rates cap that includes all fees and charges. Does not support any amendment in any form to cap the fees charged. The impact on capping would result in a probable closure of operations and would limit the opportunity for many thousands of consumers to access a needed service.
- All states and territories were urged to impose an interest rate cap. The NSW cap of 48% was considered reasonable; however, establishment fees should be included. Having a floating interest rate cap would be too confusing. A loan charging more than 48% is unconscionable. If risk of default is so high that a rate of 48% will not sustain a viable return, then the fringe credit provider should simply reject the application.

As noted above in Part 4, an impact analysis has not been undertaken with respect to this option as there is no regulatory power to implement them at a national level. It is noted however that interest rate caps remain a topic of interest for a number of stakeholders.

7. Evaluation

In this part of the RIS/PBT, an evaluation of the relative impacts of the proposals and alternatives is included to show that the desired policy objective cannot be achieved at a lower cost to business and the community at large.

7.1 Retaining the Status quo

7.1(a). General

Retaining the status quo would result in negative impacts continuing to be felt by borrowers as discussed in Part 2 above. For example, if the status quo is retained, borrowers would continue to find it difficult to compare the cost of loans, be required to provide security over essential household goods and not have the protection of the Code when loans are structured in a way to avoid the application of the Code.

The apparent recent growth in the fringe credit market could indicate high consumer confidence or represent the filling of a vacuum created by mainstream credit providers moving away from serving the needs of consumers who now access loans from fringe credit providers. Consultation confirmed some borrowers appear to have no choice but to access credit on terms offered by fringe credit providers. Retaining the status quo could result in legitimate fringe credit providers losing business because of a negative perception of some business practices engaged in by some members of the industry.

The greatest positive impact of retaining the status quo would flow to some fringe credit providers who could continue their business without change. It is possible that in the long term, increased competition may address some problems in the fringe credit market; however there will be costs to borrowers in the short-term. Governments would also face continued pressure to introduce consumer protection measures.

It appears from the consultation feedback provided that retaining the status quo is not a viable option to address all of the problems that have been identified in the fringe credit market.

7.1(b) Better enforcement of the Code

In both the short term (prior to the making of any amendments as a result of this RIS/PBT) and the longer term, there is scope for more coordinated compliance activity to take place across all jurisdictions in the fringe credit market.

Some fringe credit providers are national franchises. It is likely, given the uniform method of operation adopted by franchised businesses in general, that conduct found to be unlawful in one jurisdiction is also likely to be unlawful in other jurisdictions with the same laws. The exception to this generalisation is, of course, the matters exempted from the uniformity agreement underpinning the Code, in particular interest rate caps.

More efficient use of resources could possibly be achieved through State and Territory consumer agencies developing more coordinated and targeted compliance activities in the fringe credit market both in the short term and after the making of any amendments impacting on fringe credit providers.

It is recommended that State and Territory consumer protection agencies agree to develop a coordinated approach to Code enforcement in the fringe credit market.

7.1(c). Assisting consumers to achieve redress under the Code

The many financial and practical difficulties faced by borrowers in the fringe credit market are discussed in Part 2 above. Legal aid commissions and community legal service providers could be provided with targeted funding to assist consumers to obtain redress when fringe credit providers engage in behaviour that can be addressed by existing remedies under the Code.

It is recommended that State and Territories consumer protection agencies give consideration to targeted funding to assist fringe credit borrowers.

7.1(d). More communication activities about the Code

There appears to be a lot to gain from a nationally coordinated approach both to increasing fringe credit consumers' awareness of their rights under the Code and in making clear the obligations imposed by the Code on fringe credit providers

It is recommended that State and Territory consumer protection agencies agree to develop a coordinated approach to fringe credit market communication activities.

7.1(e). Industry and Community Initiatives

The emergence of industry initiatives for the development of loan programs for consumers that may otherwise use payday lenders has the potential to address a market need for low cost loans. The development of programs such as the ANZ Development Finance Program is still in the early stages of inception with some pilot programs proceeding in 2005. Other credit providers including the National Bank and Bendigo Bank have also undertaken similar programs, some in partnership with community organisation such as Good Shepherd Youth and Family Services and Brotherhood of St Laurence.

At this stage, there is not enough evidence that these programs would address the problems of the fringe credit industry, and indeed it is unlikely that this is the aim of such programs. Rather, they are aimed at targeting vulnerable consumers who are otherwise financially excluded from mainstream lenders.

As to whether other mainstream credit providers will also develop similar programs aimed at vulnerable consumers is not yet clear. However, it is recommended that State and Territory consumer protection agencies provide what support and assistance to the development of similar industry programs they reasonably can.

7.2 Minimal Regulatory Intervention

These are regulatory amendments that can be introduced at minimal additional cost to address current "loopholes" in the Code. Any costs are likely to be borne only by businesses that are not currently complying with the policy intent of the Code.

7.2.1. Clarify disclosure of an APR is required for all credit contracts

There is current uncertainty about whether or not the Code requires fringe credit providers who charge a flat fee only to disclose an APR. Where the flat fee incorporates an interest component, an APR should be disclosed so that borrowers can compare the cost of borrowing money.

The amendment should provide that an APR must be disclosed under s.15(C)(a) on all credit contracts where there is any interest charge.

As all fringe credit providers would be required to disclose an APR, it is likely that competition would be stimulated as the costs of credit become more transparent. In

the long term this may result in a reduction of costs for some loan products. Balanced against these benefits are the initial administrative costs that will be borne by fringe credit providers as they update their software systems to enable an APR to be disclosed. These costs would only be imposed on those fringe providers that are not currently disclosing an APR. The number of such providers is unknown. The costs to mainstream lenders (who routinely use and disclose APRs) and government would be minor.

Ensuring that credit providers disclose an APR is consistent with the Code's objective of 'truth in lending' as borrowers will be able to compare the interest rate imposed on loans between credit providers. The initial administrative costs associated with this proposal that will be borne by an unknown number of fringe providers are outweighed by this benefit.

Recommendation

The Code should be amended so that it is clear that an APR must be provided for all loans where there is a charge for credit. This provision should be based on section 10B of the *Consumer Credit (NSW) Act 1955*.

7.2.2. Extending application of existing remedies under the Code

Enabling all fees and charges and the combination of interest, fees and charges to be reviewable under s.72 of the Code would remove an artificial distinction between the various fees and charges imposed on a contract and not just those currently listed in s.72.

Section 72 of the Code presently permits a court to review a small category of fees and charges if they are unconscionable, namely an establishment fee or charge; a fee or charge payable on early termination of a credit contract; and a fee or charge for a prepayment of an amount under a credit contract. There is no clear policy reason as to why the unconscionability provisions should only be limited to these fees given the type and combinations of fees, charges and interest being imposed on contracts used by fringe credit providers. An amendment to the Code to allow all fees, charges and imposed alone or in combination with interest to be capable of being reviewed would better reflect better the market practice of imposing a wide variety of fees and charges.

Developing criteria by which unconscionable fees charges and the combination of interest would assist in providing certainty to all parties. A test for unconscionable fees and charges along similar lines to section 44 of the *Credit Contracts and Consumer Finance Act 2003* which links the fee or charge to the underlying costs or loss of the credit provider would be consistent with the existing provisions in section 72(3) and (4). Any test for unconscionable interest when considered in combination with fees and charges would be based upon the existing provision of section 70(2)(n) of the Code.

Section 72(3) requires that when deciding whether a fee or charge is unconscionable, the court is to look at the credit provider's reasonable costs. Competition would be improved if a court in determining whether a fee, charge or interest was unconscionable was also permitted to consider fees and charges reasonably imposed

by other credit providers, and the reasonableness of any payments made by a credit provider to any broker or intermediary in establishing or terminating a loan.

Section 70 of the Code presently permits a court to reopen an unjust transaction having regard to the public interest and all the circumstances of the case. This section and s.72 requires the individual debtor to take action against a credit provider. There have been a relatively small number of cases undertaken due to the small amounts of money involved and the costs and skills required to make such an application. Any cases that have been taken are generally settled prior to trial which provides little guidance to fringe credit providers about the legitimacy of their contracts, fees or charges and consequently may result in unjust or unconscionable conduct continuing.

Permitting government consumer agencies to make applications under ss.70 and 72 will significantly increase scope for unjust and unconscionable fees, charges and terms in contracts to be reviewed and remedied. This will improve competition in the fringe credit market and benefit both consumers and credit providers who do not behave unconscionably or unjustly.

Balanced against these benefits are the costs of this proposal which will mainly be directed at fringe providers as they are most likely to have loans that would be considered by a court to be unconscionable. These costs would include legal costs, the loss of a charge or fee following a successful court action and potentially the loss of profits associated with unconscionable fees or charges. Although there is potential for these costs to be ongoing, it is likely that they will be focused immediately following the amendments as industry practice adjust to court determinations of the appropriateness of fees and charges.

The other main cost is directed to Government who will bear increased compliance and enforcement costs in enforcing the wider provisions. Borrowers may also bear some opportunity cost should the proposal limit the ability of providers to develop innovative products.

Given the potential benefits of this proposal in targeting unconscionable practices, it is considered that the benefit of these proposals outweighs the costs.

Recommendation

It is recommended that the existing remedies in the Code could be modified to:

- enable all fees and charges and the combination of interest, fees and charges to be reviewable under s.72 of the Code. The test for unconscionable fees and charges should be linked to the underlying costs or loss associated with the fee or charge. The test for determining unconscionable interest will be based on s70(2)(n) of the Code;
- enable a court to consider fees and charges reasonably imposed by other credit providers in determining unconscionable interest and charges under s.72;
- permit a court when considering an application under s.72 to take into account the reasonableness of costs (and not just the credit provider's reasonable costs) incurred in establishing or terminating a loan of that type;
- clarify the operation of section 72(3) generally; and

- permit government consumer agencies to make applications under ss.70 and 72 of the Code.

7.2.3. Prevent fringe credit providers from avoiding application of the Code

7.2.3(a) Pawnbrokers exemption

The original proposal contained in the Discussion Paper may not be effective in addressing avoidance of the Code through utilisation of the pawnbroker's exemption. However, the modified proposal would make clear the exemption given to pawnbrokers in the Code is limited to the activities rightly classified as pawnbroking activities.

7.2.3(b). Broker/credit provider arrangements

Consultation confirmed the need to include the costs of brokers in determining the maximum amount of credit fees and charges that may be imposed or provided under s.7(1) of the Code (which clarifies that the Code applies to short-term, high cost lending) and that payments made in artificial broker arrangements are not used to subvert the effect of this section.

7.2.3(c). Business purpose declarations (BPDs)

Consultation feedback made clear that BPDs are routinely misused by some credit providers in the fringe credit market to avoid the application of the Code to credit provided for personal, domestic or household purposes.

The benefit for consumers of removing BPDs would be that in circumstances where they are prevailed upon to sign, they unwittingly sign or they sign based on misleading information, they will have the opportunity to argue that the presumption that the Code applies should be upheld. They will not be hampered by a conclusive presumption to the contrary.

Credit providers, brokers and linked suppliers who legitimately use a BPD are likely, in the absence of the statutory BPD, to ask debtors to sign a BPD-style form, which will give them written proof of purpose. This and other evidence likely to be available to credit providers should be sufficient to overcome the presumption in s.11(1) in circumstances where there is a genuine business or investment purpose.

7.2.3(d). Bill facilities exemption

Consultation feedback to the Discussion Paper indicated the use of bill facilities as a means of avoiding the Code is increasing. NSW and WA in particular have also noted the increased use of bill facilities by fringe credit providers in their domestic consumer credit markets.

In WA the Geraldton Magistrates Court advised that a fringe provider had lodged 137 applications for judgement summonses in the past 18 months (January 2004 to June 2005). These were all credit arrangements made pursuant to a promissory note that relied on the exemption for bill facilities in the Code. The Geraldton Magistrates Court also

advised that the number of appearances by clients of this single lender has increased from around two or three per week in early 2004, to the current rate of around 10 to 12 per week. Many clients appear a number of times for the same debt. Further, the WA Department has received reports of approximately 14 clients of the same lender appearing each week in both the Bunbury and Joondalup Magistrates Courts.

Based on statistics obtained to date, it can be conservatively estimated that in 2005, there will be at least 7000 appearances by consumers pursued through the courts for repayment of debts owed to the fringe provider operating in WA. These statistics indicate that these types of avoidance practices are on the increase and require urgent attention. Bill facilities, like other forms of credit, are also used in commercial lending. However, the removal of the exemption for bill facilities should not affect commercial lenders because the Code only applies to credit to be provided for domestic purposes. If it was found that there were in fact a greater number of personal bill facilities being utilised, the removal of the exemption could be fashioned to not apply to authorised deposit taking institutions.

Recommendations in relation to lenders avoiding the application of the Code

The benefit of these proposals is directed to consumers who would receive the protection of the Code if contracts had not been styled to avoid its application. Borrowers would be provided with disclosure and other protections and remedies that are not currently provided. The costs of this proposal would be borne by those credit providers that are currently styling their arrangements to avoid the application of the Code. These costs would be initial and ongoing compliance costs.

Addressing the exploitation of identified loopholes would meet the Code's objective in providing laws which apply equally to all forms of consumer lending and to all credit providers:

- It is recommended that the pawnbroker's exemption be amended to ensure that the exemption only applies where money is lent on the security of pledges of goods. The exemption should apply only where the sole recourse provided for failure to repay the loan is for the pawnbroker to sell or otherwise dispose of the goods pledged.
- It is recommended that the Code be amended to state that for the purposes of determining the maximum amount of credit fees and charges that may be imposed or provided under s.7(1) of the Code, a fee or charge is to include any charge paid to another party for referral to or from the credit provider irrespective of whether the party is related to the credit provider or not.
- It is recommended that the conclusive presumption about a business purpose declaration be removed.
- It is recommended a regulation be made so provision of consumer credit by way of bill facilities is not exempt from the Code. Given the urgency of this problem and the detriment that is being suffered by consumers it is recommended that this project be progressed separately to the remainder of the recommendations in this RIS if it will result in the amendment being made sooner.

7.3 Greater Regulatory Intervention

These are greater regulatory amendments that target more extreme behaviours. They are higher cost as they have the potential to affect a broad range of businesses, including those not involved in the behaviour of concern.

7.3.1 Extra disclosure requirements for high cost loans

7.3.1(a). Extra disclosure requirements – individual comparison rate

Amendments to the Code in mid 2003 introduced requirements to provide comparison rates in advertisements for fixed term credit (if an interest rate is advertised) and requires credit providers and certain others to provide a schedule of comparison rates for any such credit. The issue of individual comparison rates will be addressed in the review of the comparison rate scheme that is to be undertaken in advance of the 30 June 2006 “sunset” for the comparison rate regime. Introduction of an individual comparison rate for a loan offer may assist consumers in deciding whether to accept an offer of credit, however this must be balanced against the current requirement to provide a comparison rate schedule and the timing of the review of the current comparison rates regime.

Providing a warning stating that a loan is a “high cost loan” would reflect the arbitrary nature of any threshold and will provide limited assistance to borrowers with limited credit options or who are already “emotionally committed” to taking the loan. Such a warning would not assist a borrower contemplating a loan that is unsuitable not because of its cost but because of other conditions on the loan.

7.3.1(b). Extra disclosure requirements – information about direct debits

It appears there is support across the market for including information about direct debits. In particular, that consumers be advised of their rights and how they can obtain assistance in resolving complaints regarding unauthorised debits in relation to direct debit authorities. This proposal does not rely on the establishment of a threshold for “high cost loans” and could apply to all loans and not just loans obtained from fringe credit providers.

7.3.1(c). Extra disclosure requirements – high cost loan offer

Any formula designed to determine a “high cost loan” would be arbitrary and its relevance would be subject to interest rate changes, individual circumstances, borrowing practices and community standards. Stakeholder responses to the Discussion Paper also indicated that disclosure requirements under the Code are already comprehensive.

Recommendations

It is not recommend that the Code be amended by introducing further disclosure requirements based on a determination that a loan is a “high cost” loan.

It is recommended that the proposed extra disclosure requirements in relation to direct debit authorities apply to all applicable loans including loans provided by mainstream

credit providers. It is recommended that all credit providers be required to disclose in writing that the consumer can cancel a direct debit authority (if one is given) at any time by contacting their bank or financial institution. The warning should note that charges might be incurred if there is not enough money in the account to satisfy the direct debit and that cancellation of a direct debit authority does not change the requirement to pay back the loan. It is recommended that all credit providers disclose in writing that consumers can lodge a complaint with their bank or financial institution if there has been an unauthorised debit and who to contact for assistance in resolving complaints regarding unauthorised debits. The wording of the requirements should be developed in consultation with consumer representatives, industry and the administrators of applicable dispute resolution schemes.

7.3.2. Amending the Code to prohibit taking security over household goods, alternatively, a prohibition on taking security for loans under \$3000

7.3.2(a). Prohibition on taking security over household goods

A prohibition on taking security over household goods would be effective in ensuring that borrowers' household assets are protected, however, the proposal requires some modification to enable the operations of lenders offering loans or hire/purchase for the purchase of new household goods. These loans use security over the goods being purchased.

This amendment would need to be carefully worded so that it is not abused by credit providers buying household goods from consumers (thus providing the consumer with a sum of money in substitution for a loan) and then selling the goods back to the consumers through instalments including an interest component. It would also be important to note that such a provision would not exclude action being taken under s.70 to reopen an unjust transaction involving the taking of security not covered by the definition of "household property" in the Commonwealth *Bankruptcy Regulations 1996*, which lists goods immune from creditors in the event of bankruptcy.

A suggestion was made during consultation that there should be a prohibition on taking security over vehicles. If such a proposal were implemented, it may be difficult for some borrowers to offer any security for a loan. A credit contract may be unjust where excessive security is taken, therefore offering consumers some protection under s.70 of the Code.

7.3.2(b). Prohibition on security for loans under \$3,000

A prohibition on taking any form of security for loans under \$3,000 would impact on the ability of borrowers to obtain small amounts of credit and on lenders in obtaining any form of security when providing that credit. This is particularly so in the fringe credit market where the majority of lenders lend amounts of less than \$3,000. To prohibit any security would mean the industry would only be able to give unsecured loans.

Recommendation

It is recommended that the Code be amended to prohibit the taking of security over essential household goods and that the definition of “household property” be taken from the *Bankruptcy Regulations 1996* (Cth) 6.03.

Suppliers (either directly or through a linked credit provider) of goods the subject of loans should be exempted from the prohibition. This concession would not extend to credit obtained when goods are purchased by the credit provider from the person seeking credit. These amendments should not compromise a borrower’s ability to take action under s.70 to reopen an unjust transaction involving the taking of security.

It is not recommended that the Code be amended by prohibiting the taking of security for any loans under \$3000.

7.3.3. Noting stakeholder interest for introducing interest rate caps in the Code

Very strong and opposing views were expressed on this issue by most respondents to the Discussion Paper. Interest rate caps will continue to be seen as a potential solution to consumer detriment in the credit market or an impediment to the ability of credit providers to make a reasonable return from their business. Unless the uniformity agreement is amended, interest rate caps remain a State issue and it is therefore appropriate that the advantages and disadvantages of interest rate caps be separately examined at a State level.

8. Review

The proposed changes to the Code will be released in the form of draft amendments that will be publicly released for consultation purposes along with this RIS/PBT. However, consultation on the bill facilities proposal may be more limited as this matter is being progressed ahead of the other amendments due to the issues outlined at 7.2.3(d).

The effectiveness of the proposed changes to the Code will be monitored by the Uniform Consumer Credit Code Management Committee (UCCCMC) following their commencement. The fringe credit market is continuing to develop and a review should be conducted commencing 2 years after the amendments start.