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The Hon Bill Shorten MP
Assistant Treasurer
Commonwealth of Australia

Dear Mr Shorten MP

Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011
Submission by Community Sector Banking

The purpose of this submission is to address the provisions set out in Schedule 3 of the draft legislation (being the proposed amendments to the National Consumer Credit Protection Act 2009 (Cth) regarding Small amount credit contracts). Largely, the provisions are of concern because what is foreshadowed are unintended consequences of otherwise well intentioned drafting.

Community Sector Banking is Australia's specialist banking service for not-for-profits and works with over 5,500 organisations nationally.

Launched in 2002, Community Sector Banking is a joint venture between Bendigo and Adelaide Bank and the Community 21 consortium - whose members are not-for-profit organisations motivated towards social and economic change for disadvantaged members of Australian communities.

Community Sector Banking offers not-for-profit organisations flexible trading and investment accounts, tax saving salary options and finance for working capital, renovation and construction. Community Sector Banking develops and implements financial solutions to strengthen the not-for-profit sector and support their work.

Community Sector Banking is presently participating in the Community Development Financial Institution ("CDFI") pilot program which reports encouraging results. Through this program Community Sector Banking provides services to Indigenous communities in Western Australia and Queensland, and disadvantaged individuals and families in NSW, Victoria, Tasmania and South Australia. Community Sector Banking provides social enterprise business loans, financial literacy training, microcredit for low income earners and microcredit personal savings.

Community Sector Banking has 3 main concerns regarding the draft legislation as it refers to Small amount credit contracts, namely:

1. The provisions prevent opportunities for consumers to refinance Small amount credit contracts in circumstances where they may be able to extricate themselves from a situation of unworkable interest rates and fees, even if the refinancing institution has funds available for use by them on much better terms of interest and fees;

2. The provisions make it easy for predatory lenders to avoid having to comply with the regulations as they relate to Small amount credit contracts by simply changing the structure of their loans very slightly;

3. The provisions prevent a consumer from being able to source funds to protect their financial position, even when the consumer might freely wish to do so – the consequence of these provisions will clearly be to:

    a. take the business away from regulated Small amount credit providers who are compliant with the law and to send that business into a black market, completely unregulated and unprotected; and

    b. encourage other individuals (typically family members of a person seeking Small amount credit but who is unable to obtain it) to put themselves into debt at a potentially exorbitant cost, thereby multiplying the number of people affected by the form of predatory lending which is presently rife in the industry of Small amount credit contracts.

In dealing with each of the issues set out above, Community Sector Banking will identify the relevant provisions of the draft legislation that it is concerned will have the suspected effect and provide a simple hypothetical (but clearly foreseeable) scenario to illustrate. At the end of each example, we will suggest amendments to the proposed legislation which might alleviate or temper the concerns that Community Sector Banking presently has for the proposed Schedule 3 provisions.

Concern 1 – Refinancing and other provisions of Schedule 3

In the Media Release No. 019 of 24/04/2012 put out by The Hon Bill Shorten MP and The Hon Julie Collins MP, it was stated:

> *"Payday lending can be high risk for vulnerable or low-income consumers. People often borrow money from payday lenders in order to meet short-term commitments like rent and groceries. The interest charged on the loan is often so exorbitant it only worsens the financial position of the consumer in the long-term, who may need to take out further loans in order to pay off the original loan and the interest."*

Consistent with The Hon Bill Shorten MP's comments, Community Sector Banking also sees that individuals in dire financial circumstances often seek to refinance payday loans. Sadly, this often occurs through similarly grossly inflated interest accruing payday loans being taken out to meet the minimum repayments due under the first loan, thereby spiralling the borrower into further increasing interest and fees on loans they already can't repay. For the purposes of this submission, we refer to this process as "toxic refinancing".

There is scope for CDFI and other programs to assist individuals to break that cycle of toxic refinancing, by refinancing these payday loans on far better interest and fee terms and conditions. For the purposes of this submission, we refer to this process as "beneficial refinancing".

The presently drafted provisions in Schedule 3 however, will prevent beneficial refinancing from occurring, thereby trapping individuals in their current unsustainable loans and sealing the fate of their initial choice to source funds from a payday lender at exorbitant rates and fees.

The relevant provisions of the draft legislation are Schedule 3 – ss. 124B, 124C, 133CB, 133CC, 133CD.

Scenario:

> *Samera works as a cashier at a convenience store and supports her 3 small children. She takes out a 2 year loan for $1,500 with a payday lender at the rate of 48% per annum to pay for a new fridge and to assist with registration for her car. After a period of time, Samera starts to fall behind in her repayments and incurs fees to the payday lender for late repayments. 12 months into the loan, Samera still owes a total of $1,700 (taking into account the interest and the fees charged).*
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> *In speaking with a colleague at work one day, Samera hears about a credit offer from another institution to the effect that she would be able to borrow up to $2,000 at just 14% interest per annum, payable over 2 years. That amount would allow Samera to refinance the full amount of her original loan and put her in a much better position to repay the balance of monies borrowed quicker and with more manageable instalment payments so that she does not fall further into debt.*
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> *Due to the operation of the proposed ss. 124B, 124C, 133CB, 133CC and 133CD, Samera would not be able to enter into this arrangement and the beneficial refinancer would not even be able to advertise to Samera about the opportunity. Consequently, Samera would be stuck with the original toxic loan, ending up paying a far greater amount of interest and fees (assuming she could continue to meet the required repayments under the original loan agreement).*

Amendment to proposed provisions:

The proposed provisions simply need to be amended slightly by adding a provision to the effect:

> *A licensee does not commit an offence under this Division if the effect of suggesting, assisting with, entering into or refinancing of an existing Small amount credit contract under these provisions, is to provide finance on better terms to the consumer than under the existing Small amount credit contract(s) that the consumer had previously entered into.*

The proposed placement of such a provision would be at the end of Part 3-1 Division 7 and at the end of Part 3-2C Division 2.

Concern 2 – The proposed provisions will not be complied with by certain lenders

The Small amount credit contract industry is notorious for the entities who make it their business to find creative ways to take advantage of the people who come to them in times of financial need. Those consumers typically have no proper understanding of their rights to be protected from predatory lending and unfair dealing.

The provisions in Schedule 3 of the draft legislation only apply to Small amount credit contracts as defined by the amendment proposed to s.5(1) of the Act. Those provisions require compliance only so far as:

(a) the contract is not a continuing contract [ie no credit cards];
(b) the credit provider under the contract is not an ADI [ie no banks or credit unions]; and
(c) the debtor's obligations under the contract are not secured by a mortgage; and
(d) the credit limit of the contract is $2,000 (or such other amount as is prescribed by the regulations) or less; and
(e) the term of the contract is 2 years (or such other number of years as is prescribed by the regulations) or less; and
(f) the contract meets any other requirements prescribed by the regulations.

If any lender wished to avoid the proposed provisions, they would simply ensure that the term offered to borrowers is set at 25 months, or that the amount loaned is $2,001. In circumstances where that occurred, the proposed provisions set out in Schedule 3 of the draft legislation would not apply to that credit contract.

There are disclosure provisions in Schedule 3 to the draft legislation but those amendments require certain disclosures on websites regarding Small amount credit contracts and not also explicitly in hard copy form. Many people who find themselves in need of Small amount credit contracts do not have immediate access to the internet in their homes, or are not computer literate.

Scenario:

John is given a payday loan of $2,001 at a rate of 48% plus a 20% establishment fee. He does not know that the amount of money he was given exceeds the amount defined in s.5(1) of the Act for a Small amount credit contract. All he knows is that the lender is charging him the same rate that his sister was charged when she was in financial difficulty and needed funds recently. John uses the money to pay for a new fridge and for repairs to his car. 12 months into the loan, John's car breaks down again and he needs to borrow a further $2,500 so he goes back to the same lender and is given a further loan on the same terms for $2,500. John's current amount of debt is in excess of $5,000 (with interest and fees) and is continuing to accrue interest at the rate of 48% per annum.

Due to the fact that both of the loans that John obtained were in excess of the $2,000 maximum for the definition of a Small amount credit contract, John does *not have the protection of the proposed amendments to Schedule 3 of the draft legislation.*

Amendment to proposed provisions:

The proposed regulations need to make abundantly clear that a Small amount credit contract is limited to the terms defined in s.5(1) in plain English and they need to require hardcopy (not simply website) disclosure by licensees at the time of providing credit applications, so that consumers are aware of those provisions and the protections offered by them.

Concern 3 – The proposed provisions will encourage black market borrowing

The types of things that people take out Small amount credit contracts for are items such as whitegoods, car insurance/repairs/registration, rental bonds, costs of trade tools and other everyday living expenses.

Community Sector Banking is concerned that some of the proposed provisions for Small amount credit contracts will force consumers away from the regulated financial market into a 'black market' form of borrowing.

The proposed legislation would prevent a consumer from obtaining one Small amount credit contract for one item and then seeking another Small amount credit contract (or even an increase to the existing contract), prior to paying out the first loan, irrespective of the terms of the loans.

In circumstances where a consumer may have access to Small amount credit on very reasonable terms, these provisions would prevent the consumer from seeking to vary the terms of that contract so as to account for a change in relevant circumstances even where there is no issue as to the fairness of the terms of credit or the person's ability to repay the amount sought.

The effect of these provisions is such as to force the consumer to:

(a) predict his or her financial needs for up to the next 2 years so that they have access to funds to cover any change in circumstances which might arise prior to discharge of the initial Small amount credit contract; or

(b) failing (a), leave the consumer with no option other than to go to an unregulated source of credit, such as an unlicensed entity or perhaps even criminal figures willing to loan money; or

(c) have his or her family members take out separate Small amount credit contracts in their own names to cover the additional change in circumstances, such that multiple persons within the one household are debtors under such contracts each with interest rates of up to 48% per annum plus up to 20% establishment fees, perhaps though all of them being dependent upon a single breadwinner to refinance such loans (and in the absence of the breadwinner being able to do so, each of them separately defaulting).

The relevant provisions of the draft legislation are Schedule 3 – ss. 124B, 124C, 133CB, 133CC, 133CD.

Scenario:

> *John works as a cashier at a convenience store and supports his wife and 3 small children. John takes out a 2 year loan for $1,500 with a payday lender at the rate of 48% per annum to pay for a second-hand fridge and to assist with registration for the family car.*
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> *6 months into the loan, the car's engine breaks down and needs substantial repairs. John needs the car to be able to drive to work. John and his family have no savings to repair the car and under the proposed legislative provisions, John is unable to be granted a further Small amount credit loan.*
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> *As John is aware that he cannot go back to his payday lender for an extension of his current loan, or for another loan, John's wife Jane seeks a loan from that lender in her name for $2,000 to fix the car. She is granted a loan on the same terms as John (namely, 48% interest per annum plus a 20% establishment fee).*
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> *John and Jane fix the car and John is able to continue to work. However, he struggles to meet both repayments under his and Jane's loans with the payday lender. With the mounting interest and fees, John and Jane default under both loans.*
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> *John is in desperate need to refinance both loans but because his children are all minors, none of them can enter into a contract with another payday lender. John hears through a work colleague of a lender who is issuing loans at 14% interest per annum but because of his and his wife's existing loans and the provisions of the proposed legislation, the lender will not be able to assist (as it does not wish to be in breach of the proposed legislation).*
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> *At a social gathering, John meets a man who tells him that he would be prepared to loan John the money, at 30% interest paid in cash, fortnightly until the loan is paid out. John knows the man is clearly not a licensee but given the terms are better than his current payday lender, John agrees to borrow the money from the man so as to enable him to discharge his present payday loans. Unbeknownst to John, the man is heavily involved in the criminal underworld and 2 months into the repayments, raises John's interest rates to 100% per annum under threats of violence. John is too scared for his family to go to the Police.*

This scenario is conceivable.

Amendment to proposed provisions:

The proposed provisions simply need to be amended slightly by adding a provision to the effect:

> *A licensee does not commit an offence under this Division if the effect of suggesting, assisting with, entering into or refinancing of an existing Small amount credit contract under these provisions, is to provide finance on better terms to the consumer than under the existing Small amount credit contract(s) that the consumer had previously entered into.*

The proposed placement of such a provision would be at the end of Part 3-1 Division 7 and at the end of Part 3-2C Division 2.

Conclusions

Community Sector Banking applauds the Commonwealth's desire for reform in the payday loans area. Our only concern is that the unintended consequences of the presently proposed legislation will be to oust the very effective simultaneous efforts of CDFI's and other institutions seeking their own practical ways to reform the industry through cheaper and more available means of finance to people in need.

It is submitted that if the Commonwealth takes into account the submissions made above, then an effective legislative reform will take place without affecting the sector's own reforms (ie by freeing up supply and creating programs which allow finance to be made available to more people, on far better terms than payday lenders will ever offer).

The legislative reforms must leave open the opportunity for these sector reformists to continue to be able to offer such products without the same types of restrictions that are made necessary by the payday lenders' gouging of vulnerable consumers. The most practical and effective way to do so, is to take into consideration in the course of making the amendments, the ability for finance to be made available "on better terms" by the market, as a means of freeing up supply and not restricting it (and in doing so, giving consumers liberty to find the best deal that the market can offer).

Community Sector Banking would be pleased to address in further detail any matter referred to in these submissions, or indeed any other matter relevant to the proposed reforms. For comment, please contact our Executive Director, Peter Quarmby on 02 4255 8400 or by email peter.quarmby@csbanking.com.au.

Yours faithfully

Peter Quarmby
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Community Sector Banking