First Stop Money Limited

Response to the

Consumer Credit and Corporations Legislation Amendment (Enhancements) Bill 2011: Reforms in relation to small amount credit contracts

released by the Department of the Treasury, April 2012

Introduction

There is, we believe, one fundamental flaw that cuts through the entirety of the proposed enhancements - amended or not; and which ignores the findings of the Parliamentary Joint Committees and submissions thereto.

This flaw is:

The assumption that all users of small amount credit contracts are financially vulnerable or low income earners

This simply is not true and the refusal of the Minister and Treasury to accommodate this in the legislation is ignorant of market forces and changes in the use of various forms of credit globally.

First Stop Money Ltd provides small amount short term loans to more than 2,500 customers each month.

In the last 3 months, during which period over 4,000 different people borrowed from First Stop Money, the following statistics prove the flaw in the above assumption:

Statistic	**Number**
% of loans to people whose primary income is from Centrelink/Self Employed	3.6%*
% of loans to people whose income is less than $30,000 p.a.	12.9%
% of loans to people whose income is greater than or equal to $60,000 p.a.	25.1%
Average Gross Annual Salary	$49,750
Lowest Gross Annual Salary	$12,000
Highest Gross Annual Salary	$178,000

*N.B. First Stop Money only lends to existing customers who were on Centrelink/Self Employed 12 months ago when First Stop Money accepted new customers with these income streams.

Consequently, First Stop Money remains incredulous that the legislation intended to protect the financially vulnerable is even being debated with companies like ourselves who have limited dealings with people who would be termed "financially vulnerable" (which requires defining anyway) when 87.1% of our customers are in full time employment, earning over $30,000 per annum and could not be regarded as financially vulnerable under any circumstances.

The purpose of this submission is for First Stop Money to expose the flaw with the "one size fits all" approach by the Minister and to enlighten the Minister and Treasury that their "well intentioned" actions will negatively affect people they are not trying to protect.

The move from Credit Cards to Small Amount Credit Contracts – People are CHOOSING payday loans

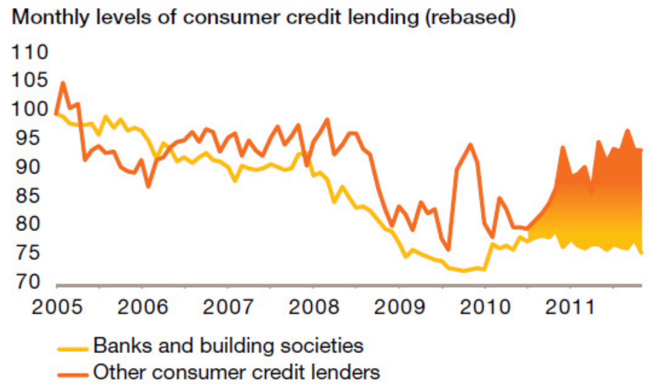
Leading Global Corporate Finance Services organisation, Price Waterhouse Coopers released a U.K. study in February 2012 entitled, *"Precious Plastic".*

The report showed that short term (payday) loans were becoming the credit of choice in the UK, a marketplace not dissimilar to that in Australia:

*"Difficulties accessing credit from mainstream sources has fuelled rapid growth in alternative sources of borrowing such as so-called payday loans. Mainstream lenders should be alert to the possibility that what may have begun as a relationship of necessity, may endure as consumers are pleasantly surprised at the convenient and innovative service they receive from these smaller, more agile providers." (*Page 4 of the report)

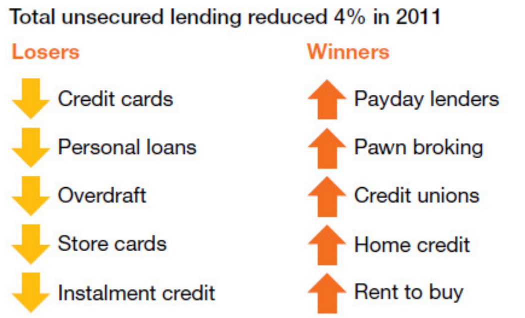
The following information take directly from the report is demonstrative of the change in mood and choice of consumer credit caused both by the restrictions evident from "mainstream lenders" and the move to more technically capable and efficient payday lenders:

Figure 6: Retreat of mainstream lenders



Source: Bank of England, PwC analysis

Figure 7: Market opens up to new players



Source: PwC analysis

(Page 13 of the report)

The fact is that people are choosing to use short term alternatives rather than take the risk of burgeoning and potentially endless debt with revolving credit products such as credit cards, understanding now that paying only minimum payments (which the majority of people do) can take over 40 years to repay a simple $5000 credit card drawdown during which time they can redraw and repay for longer! A true debt spiral if ever there was one.

Fox Symes research says that almost 50% of Australians only make the minimum payment on a credit card… (http://www.foxsymes.com.au/articles/How-to-Get-Out-of-Credit-Card-Debts)

First Stop Money Ltd wants a fair playing field which protects those who ARE financially vulnerable or disadvantaged but allows market forces to determine customer choice for those who are not.

Summary of Issues

The Minister's approach has been to creative a prohibitive and non-competitive marketplace, if indeed a marketplace will even exist after the introduction of the legislation.

The Minister continues to justify his actions by using ineffective price comparisons such as annualised percentage rates and by claiming that all users of small amount short term credit contracts are financially disadvantaged and vulnerable, plunging into a debt spiral.

The facts are that:

- Short term loans generate a smaller gross margin than other credit products despite incurring similar costs to assess and administer, it's not as profitable as you think

- Short term loans are neither the greatest cause nor have the greatest potential for debt spirals
    - The GFC was caused by sub-prime mortgages, not payday loans

- A considerable and ever growing number of financially savvy people are choosing to control their own borrowing habits by selecting a short term loan from the options available to them *(see the attached PWC report, "Precious Plastics")*

- People are staying away from credit cards as they don't want to borrow $5000 to fix a $500 problem.

First Stop Money says:

- YES!

  Provide greater protection for those who are financially disadvantaged or vulnerable

- YES!

  Define them by setting a personal income limit/source

- NO!

  Don't introduce a blanket regulation on the industry, regardless of the means, awareness and financial inclusion of consumers who don't fit your narrow definition

- NO!

  Don't exclude those who aren't financially vulnerable from making an educated decision when they want

- NO!

  Don't create an uncompetitive market place by fixing costs for those who do have a choice of credit alternatives

The Prohibition on Multiple Contracts – The Lack of Logic

Two consumers earn $60,000 per annum (net $3,958.33 per month).

Consumer A takes out three long term loans for $9,000 each over 3 years through different banks on the same day.

Consumer B takes out three short term loans for $300 each over 2 months through different providers on the same day.

Prevention on this is practically impossible as a lender only has recourse to the number of searches made on the consumer's file and a consumer can deny that they have been funded by other providers. (Veda Advantage research states that 1 in 10 people lie on the credit applications). In actuality, it would be perfectly possible that a consumer could press the apply button at the same time on two applications meaning neither would register a previous credit check as they both happened simultaneously.

{Assumptions: each provider has offered the same terms and fees: Term loans = 11.99% APR; Short term loans = 35% flat fee}

Consumer	Total Indebtedness (Net of Fees)	Total Gross Indebtedness	Term of Debt (months)	Total Monthly Repayments	Monthly Repayments as % of net Monthly Income
A	$27,000	$32,279.67	36	$896.67	22.7%
B	$900	$1,215	2	$607.50	15.3%

Questions for you to consider:

Which customer is "worse off" or in greater risk of a debt spiral?

Which customer has a higher percentage of their income payable in instalments?

Which customer has a greater chance of their circumstances changing before the end of their loan term?

Which customer is themselves borrowing less responsibly?

In the cases above, it is obvious that Consumer A is at a greater risk, yet in both cases, the same responsible lending checks may have occurred. Yet this legislation acts against the consumer at lesser risk, probably due to the assumption that all SACC borrowers would be ineligible for higher value loans and that Consumer A does not exist in the SACC market ***but they do***.

The Prohibition on Repeat Loans – The Contradiction of Credit Cards

Consumer C applies and is approved for a $10,000 credit card and a $300 short term loan on the same day.

They use the short term loan and repay it over their next 3 paydays, leaving the credit card for emergencies.

Two weeks later, they lose their job. They reapply for a payday loan but are found to be unsuitable upon a simple job check with no immediate income to repay the loan.

They then withdraw the $10,000 in one lump sum from the credit card and go on to default as they have no income to repay the loan.

Questions for you to consider

Where is the greater risk to the consumer's indebtedness and debt spiral?

Which is the most responsible form of credit provided?

Once again, it is indubitably the short term loan.

But the Charges are So High! - Comparing "Payday" Loans with other Unsecured Loans – Gross Margins and the Risk of Long Term Indebtedness.

It is a fact that employed mid-income earners are not excluded from other forms of credit and nor should they be from short term credit facilities. Given the profile of First Stop Money's customers, this is the greatest issue created by the Enhancements Bill.

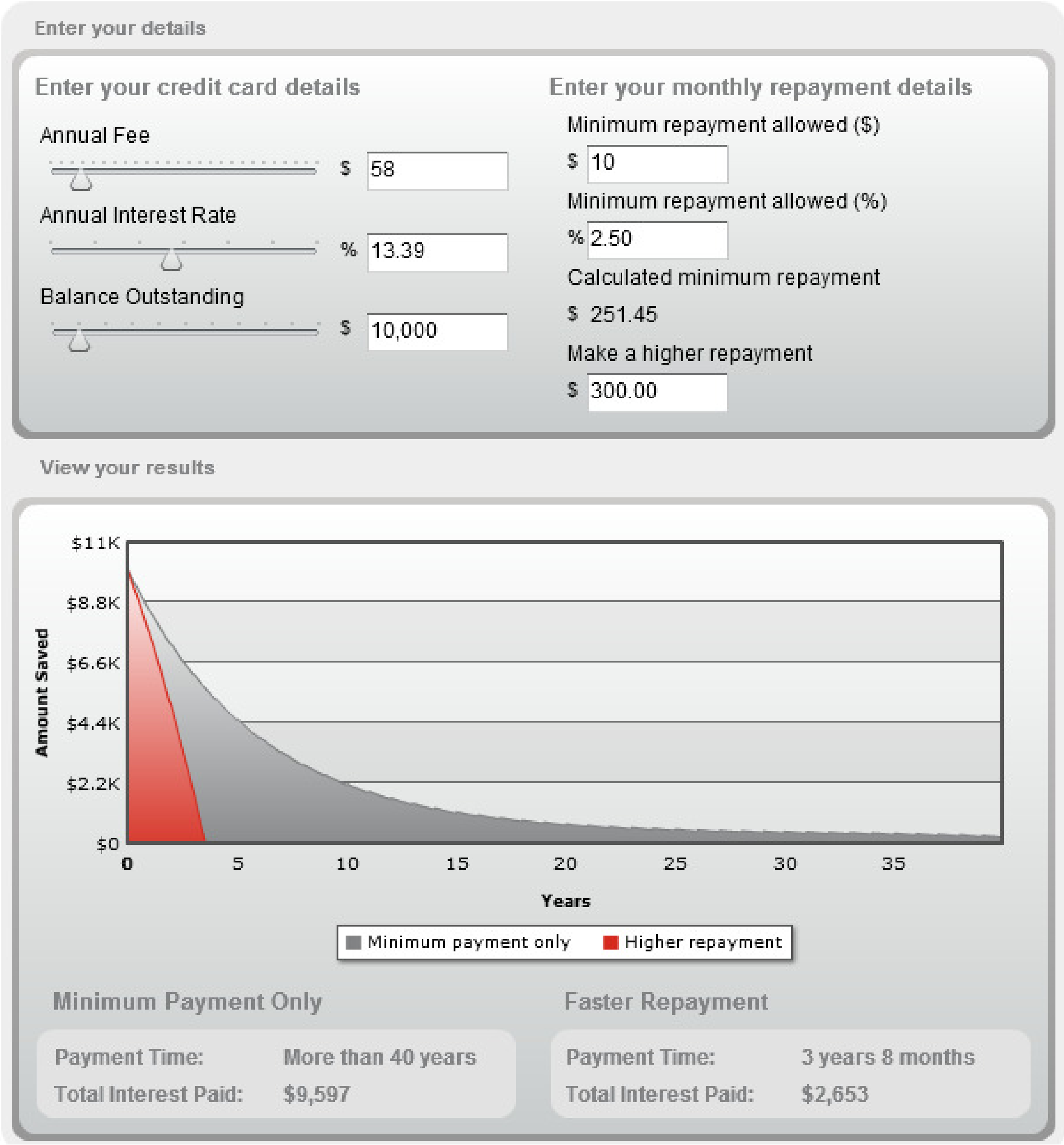
And yet, when considering the gross margin for the credit provider or the risk of long term indebtedness for the consumer, a short term loan is – if a customer is looking for a small amount of money – the fairest option.

Loan Type	Principal	Term	Annual Interest Rate	Fees	Total Repayable	Gross Margin
First Stop Money (short term loan)	$300	27 days	0%	36.5%	$409.50	36.5%
ANZ Personal Loan	$10,000	5 years	11.99%	$750	$14,093.64	40.9%
ANZ Standard Variable Home Loan	$150,000	25 years	7.52%	$2,250	$335,381.67	123.6%
ANZ Low Rate Credit Card (Minimum Payment Only)	$10,000	> 40 years	13.39%	$80 p.a.	$19,597	95.97%

(Please note, rates and total repayment calculations for ANZ loans were taken from the ANZ website calculator on 14 May 2012. The ANZ Personal Loan includes a $150 establishment fee and a quarterly fee of $30 per quarter; the ANZ Standard Variable Home Loan includes an establishment fee of $600, a valuation fee of $150 and a monthly loan administration fee of $5. None of these fees are clearly explained on the site or included in the repayment calculators.

For the purpose of calculating the cost of the credit card on minimum payments only, a calculator doesn't exist on ANZ's site demonstrating the true potential cost, so First Stop Money has used the calculator on http://www.home-loans.com.au/calculators/credit-cards/ on the costs of credit cards where only minimum payments are made to calculate the amount repayable to the ANZ credit card on minimum payments only)

Screen Shot Credit Card Minimum Repayment Calculator [© home-loans.com.au]



Conclusion

First Stop Money *is* supportive of measures which protect the financially vulnerable. However, First Stop Money remains convinced there is a flawed naivety in the legislation that does not recognise that many users of Small Amount Credit Contracts are *not* financially vulnerable – evidenced by the fact that 87.1% of First Stop Money customers earn in excess of $30,000 p.a. and that this *must* be considered in final legislation with a line drawn in the sand allowing market forces to drive industry competition for those for whom use of Small Amount Credit Contracts is an educated choice and for whom short term loans are just one tool in their financial toolkit.

First Stop Money has also included its submission to the Joint and Senate Committees for your information and the PWC study, *"Precious Plastics"*.

Should you have any further questions, please contact:

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Thank you for taking the time not only to read this submission but also to digest and consider it carefully.

We hope that this submission will dispel the myth that all SACC borrowers are financially vulnerable and persuade the Minister and Treasury to take action which does protect the financially vulnerable but which does not disadvantage the financially capable.

This can only be done by defining "the financially vulnerable" with an income limit, legislating intelligently to protect those below the line and allow consumers above the line to drive market prices.