Final Report of the Review of Small Amount Credit Contract (SACC) Laws (Review)

Submission by Credit Corp Group Limited (Credit Corp)

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Executive Summary

Credit Corp is supportive of the majority of the recommendations contained in the Review, but has identified significant shortcomings which can be addressed through just two further amendments.

Credit Corp has identified that the impact of the 10% of net income repayment cap, in the absence of any repeat borrowing restriction, will result the effective 'monopolisation' of individual consumers by existing operators with continuously revolving short-term SACCs of less than 90 days duration. This will decrease competition and preclude SACC consumers from switching to cheaper alternatives.

The introduction of a 4% monthly fee cap for consumer leases will create a regulatory arbitrage in favour of consumer lease providers over cash instalment loans of an equivalent term. Consumer lease providers will have the opportunity to charge full retail prices and extract excess margins on leased goods, without any effective competition from mainstream retailers offering discounted goods.

Credit Corp recommends the introduction of a 60 day 'cooling off' period where lenders are prohibited from issuing an SACC to a consumer who has been a debtor under an SACC in the preceding 60 days. This will stimulate competition by releasing the consumer to explore cheaper borrowing alternatives.

Credit Corp also recommends removing the regulatory arbitrage created by the introduction of a new concessional fee cap for consumer leases by allowing for an equivalent cash loan at the same cap. This will provide for more effective competition to consumer lease providers and reduce the potential to inflate retail prices when setting repayments. It will also provide for a cheaper and more affordable loan to compete with the SACC segment to the benefit of consumers.

Company Profile

Credit Corp is Australia's largest provider of sustainable financial services to the credit impaired consumer segment. The company has been listed on the Australian Securities Exchange since 2000 and forms part of the S&P ASX 200. Credit Corp employs 1,000 Australians and the face value of its total receivables is $5.5 billion across 800,000 consumers.

Credit Corp has a proven track record of promoting financial inclusion.

In our core business of debt purchasing we work with consumers who have, for various reasons, found themselves in default of their credit obligations. We agree affordable repayment plans with our customers and improve their credit standing over several years as a pathway to financial inclusion. We maintain the most successful hardship program in the industry with a current portfolio of $1.1 billion of defaulted consumer credit obligations, restructured into sustainable repayment arrangements across 140,000 individual customer accounts.

In our consumer lending business we provide the cheapest and most sustainable loan products to consumers with limited borrowing alternatives. All of Credit Corp's products feature interest and fee rates well below applicable caps and affordable repayments. To date, Credit Corp has helped 100,000 Australians avoid higher cost and unsustainable 'payday loans' through its market leading alternatives.

Credit Corp has an impeccable compliance record. Despite being the largest and longest-established debt purchaser in Australia, we have never been the subject of a regulatory order or undertaking. We have one of the lowest rates of External Dispute Resolution (EDR) complaints in the industry and have never incurred a reportable systemic issue. We work cooperatively with consumer advocacy groups on matters of industry concern and have a long term partnership with Kildonan Uniting Care.

SACC Market Exit

Credit Corp entered the SACC market in July 2013 in line with changes to the *National Consumer Credit Protection Act 2009* (Credit Act). The changes provided the opportunity for Credit Corp to introduce competition to the SACC market through substantially cheaper rates, more affordable repayments and sustainable product features. Unfortunately, Credit Corp was forced to withdraw from the SACC segment in February 2016, leaving consumers without an alternative to unsustainable and predatory loan products.

Credit Corp's SACC offering uniquely met the public policy objectives of the 2013 reforms to encourage mainstream competition, responsible lending and solutions with affordable repayments to minimise repeat borrowing and the risk of consumers being caught in a debt spiral. The analysis contained in our submission to the Review shows that 85% of SACCs are being issued for terms of up to 90 days with repayments which, on average, account for 14% of borrower income leading to an unacceptably high rate of repeat borrowing and debt spiral. Credit Corp's unique SACC was for a minimum term of four months, at fee rates well below the caps and with repayments which, on average, accounted for just 5% of borrower income. Our offering did not compel repeat borrowing and provided the 540,000 consumers who take out SACCs each year with a much cheaper, safer and more sustainable alternative.

Through lower fee rates and a longer average term Credit Corp was providing loans to SACC consumers at a fraction of the total effective interest rate or Annual Percentage Rate (APR) charged by all other market participants. Almost all other market participants charge the maximum fees permissible under the Credit Act of a 20% upfront fee and a 4% monthly flat rate fee, while Credit Corp's SACC fees were 15% and 2%, respectively. As noted above, 85% of all SACCs are issued with terms of up to 90 days and the average such loan is for a term of just 37 days. The average term of Credit Corp's SACC was 6 months. The APR applicable to the average market sub-90 day SACC is 387%pa, whereas the APR applicable to Credit Corp's SACC was 83%pa. One of the consequences of Credit Corp's exit from the SACC market is that credit impaired consumers are now paying almost five times as much when they borrow money.

Credit Corp's decision to withdraw from the SACC segment was a consequence of the application of the pejorative term 'payday loan' to all SACCs by the Australian Securities and Investments Commission (ASIC) from the publication of its Report 426 in March 2015. The extensive analysis provided in our submission to the Review demonstrates that there is no other local or international precedent for applying the term 'payday loan' in this way. The analysis shows that the precedents are consistent with a definition limited to loans with terms of no longer than 90 days. Notwithstanding this, as a mainstream ASX 200 financial services company with a strong commitment to sustainability Credit Corp was subject to intense stakeholder pressure to cease providing a product which attracted such a pejorative description from Australia's peak financial services regulator.

Credit Corp was forced to succumb to this pressure, leaving 540,000 consumers in the hands of predatory business models unfettered by the discipline of sustainable competition.

Response to the Review

Overview

Credit Corp is supportive of the majority of the recommendations contained in the Review. The implementation of a universal cap on SACC repayments of 10% of net income (Recommendation 1) should ensure that repayments are more affordable for those very low income and welfare dependent consumers who comprise the bulk of Australia's shopfront 'payday loan' (correctly defined as loans with terms of up to 90 days) borrowers. Credit Corp does not support the complete removal of repeat borrowing restrictions (Recommendation 2) and the failure to recommend other measures to encourage new competition by responsible mainstream operators offering cheaper and more sustainable products to help drive out predatory business models and minimise the scope for avoidance. Credit Corp does not believe that the ban on unsolicited offers (Recommendation 8) will be effective in discouraging continuous use of high cost short term loan products.

Credit Corp's chief concerns are that: (1) without an effective repeat borrowing restriction the 10% repayment cap will effectively enable incumbent providers to monopolise individual consumers, and (2) without a class of loan products which will not attract pejorative description mainstream operators will not enter the segment to provide cheaper and more responsible products to SACC consumers. Credit Corp is also concerned that the recommendations may result in the unintended consequence of a return to the multitude of shop-front avoidance models which proliferated prior to the July 2013 amendments to the Credit Act. Credit Corp proposes some simple measures to address these concerns and complement the recommendations contained in the review.

Shorter Term Revolving SACCs

For employed consumers the combination of the 10% repayment cap and the removal of restrictions on repeat borrowing will exacerbate continuous dependency on a very high cost product and will stifle the potential for price competition.

The Review proceeds on the assumption that a 10% repayment cap will lead to much longer duration SACCs for all consumers. Ignoring the potential for avoidance, there is some likelihood that this will be the case for the very low income, and largely welfare dependent consumers, who comprise the bulk of shop-front SACC borrowers. For employed consumers with net incomes above $50,000pa, however, there will not be a material lengthening of loan durations and the 10% repayment cap will limit the scope for consumers to switch to a cheaper provider.

The Review has failed to take account of the economic incentives facing SACC issuers. Unit economics have produced the situation where 85% of all existing SACCs are issued for terms of up to 90 days. Short duration, heavily repeating loans produce a much higher total effective return, or APR. As noted above, the average sub-90 day SACC produces a total effective gross return of 387%pa, whereas the same loan over a term of six months will produce a gross return of 148%pa.

Short durations not only produce higher gross returns but also reduce credit losses. ‘Payday lenders’ report credit losses of around 7% of the total amount advanced across the average term of 37 days. The risk of default in lending to credit impaired consumers is relatively linear, or even, over the term of any loan. Accordingly, for a 6 month loan to the same consumer credit losses will be approximately 35%. The economic incentive to issue and repeatedly roll over the shortest duration loan permissible is best demonstrated in the following simplified table:

Simplified SACC Lender Unit Economics (pricing at cap)

	Single 35 day loan	**5 x revolving 35 day loans**	**Single 6 month loan**
Amount advanced	$500	$500	$500
Total Fee	$140	$700	$220
%	28%	140%	44%
Average Credit Loss	$(35)	$(35)	$(175)
%	(7)%	(7)%	(35)%
Fee Net of Loss	**$105**	**$665**	**$65**
%	21%	133%	13%

The table shows that an SACC operator offering revolving $500 loans of 35 days each over 6 months will derive a fee net of losses of $665, whereas an operator offering the same customer a single $500 loan over 6 months will derive a fee net of losses of only $65. In the absence of regulatory and competitive forces unit economics will drive SACC providers to issue loans for the shortest term permissible.

The 10% repayment cap will not materially lengthen the term of SACCs issued to employed consumers. Material relating to the leading online ‘payday loan’ provider shows an average loan amount of $500 over 35 days, with fortnightly repayments of $256. Simply extending the term by another 7 days will bring repayments to 10% of the average stated fortnightly net income of the leading online provider’s borrower of $2,000 or $52,000pa. The leading online provider will be able to continue to provide a very short term loan to its average consumer. By continually rolling over this loan the provider will completely consume all of the consumer’s statutory repayment capacity.

In the absence of a repeat borrowing restriction the outcome of the Review recommendations is that employed consumers will be in a state of constant ‘payday loan’ indebtedness to a single SACC issuer. It is readily foreseeable that the recommendations would lead to a large number of instances where borrowers are continually indebted over the course of a year, paying fees totalling approximately $1,200 for a loan of just $500.

There will be no scope for this borrower to refinance into a cheaper and longer-term SACC because all of their statutory repayment capacity will be consumed by the ‘payday loan’. In this way the consumer will become dependent on one SACC issuer and will effectively be monopolised by that operator. There will be no scope for competition by an operator offering a lower cost alternative.

Likely Ineffectiveness of Ban on Unsolicited Offers

Credit Corp does not believe that the ban on unsolicited offers (Recommendation 8) will be effective in discouraging continuous use of high cost short term loan products. While such controls may be effective in limiting a credit limit increase on a credit card they will not be effective in limiting repeated use of a short term instalment loan to a credit impaired consumer.

The SACC borrower will continue to return to their existing provider for a number of reasons. The short duration of each loan means that provider is likely to be top-of-mind. A large proportion of credit impaired consumers exhibit a continual desire for credit. Research shows that most credit impaired consumers are aware that they have limited borrowing alternatives and will return to the same lender rather than risk rejection from a new lender. The use of mobile applications, members' areas, payment reminders and electronic statements reinforce the availability of instant credit offered by a consumer's existing provider.

In the absence of any repeat borrowing restrictions most SACC consumers will look to continuously borrow from their existing provider.

Unintended Consequences - Avoidance

One of the most important impacts of the July 2013 changes to the Credit Act has been the eradication of the multitude of shop-front 'payday lending' avoidance models which previously existed to circumvent the unrealistically low 48% APR cap which existed in some Australian States. On-line transactions are more transparent and more readily auditable, limiting the potential for avoidance. The introduction of a more realistic fee cap has allowed online operators to more effectively compete with shop-fronts, which has had the effect of driving out avoidance models.

Credit Corp is concerned that the recommendations will compromise the ability of existing online operators to compete. This may give rise to the unintended consequence of a return to shop-front avoidance models.

Regulatory Arbitrage for Consumer Leases

Credit Corp notes that the Review's recommendation for consumer leases will create a regulatory arbitrage which may be exploited to the detriment of consumers.

The Review has recommended a completely new concessional interest rate for consumer leases (Recommendation 11). The panel recommends a 4% flat monthly cap, which equates to an APR of 86%pa. Most consumer leases are for goods with a retail market price of less than $2,000 and are for a term of more than one year (most commonly three to four years). The corresponding cap for a cash loan equivalent is an APR of 48%. This is an obvious regulatory arbitrage where an operator who packages a household good with finance can charge twice as much as the operator who provides the consumer with a cash loan.

This arbitrage will create the situation where vulnerable consumers will be prone to exploitation. The bulk of consumers taking out appliance leases are welfare dependent and have no other commercially available finance alternatives. Most consumer lease providers do not actively compete in the wider appliance sales market and therefore charge a full undiscounted recommended retail price (RRP). In fact, the largest appliance rental operator sells its own branded product with its own unique RRP, creating the potential for using an inflated retail price when calculating its APR.

The entire retail interaction is prone to significant exploitation. Many consumers are sold the largest and highest priced product, when they may have entered the retail premises with the intention of acquiring a more modest item. This will not change under the Review's recommendations.

To ensure integrity, consumer choice and competition this regulatory arbitrage should be removed. While this can be achieved by imposing a 48% APR on consumer leases, such a measure will not prevent exploitation of retail margins by consumer lease providers because it will not facilitate a competing alternative for the credit impaired consumer. Credit Corp recommends that a long duration cash loan equivalent to a consumer lease, with the same 4% monthly flat rate cap, is introduced. This will feature all the same controls as those recommended in the Review for a consumer lease.

Credit Corp's proposal will limit the scope for exploitation by allowing for competition. Consumers will have the option of borrowing at the consumer lease rate while shopping around for the cheapest and most appropriate appliance which meets their needs. The discipline of competition will keep those remaining consumer lease providers honest (we anticipate that only one or two larger operators will remain in the market).

The introduction of a 4% monthly flat rate cap cash loan will also provide more effective competition for the SACC sector. It will allow for a cheaper and longer-duration loan to be issued to consumers whose only alternative will be a higher cost 'payday loan'.

Simple Solutions

Two additional measures will complement the Review's recommendations and will address the shortcomings identified above.

Credit Corp recommends the implementation of simple bright line repeat borrowing restriction. We recommend the insertion of a 60 day 'cooling off' period from the last point where a consumer was indebted under a SACC. This will prohibit SACC providers from issuing a loan to any consumer who was a debtor under an SACC in the preceding 60 days.

This repeat borrowing restriction will:

- ensure that a high-cost and very short-term loan does not become a revolving indebtedness;
- provide consumers with a period to explore cheaper borrowing alternatives;
- free up statutory repayment capacity to enable increased competition by SACC issuers offering lower rates over longer terms (lower APR) to the benefit of consumers;
- be easy to implement using the existing requirement to obtain 90 days of bank statements (by identifying SACC deposits/repayments over the preceding 60 days); and
- bring Australia into line with the US federal regulator's (Consumer Financial Protection Bureau – CFPB) proposal for a 60 day 'cooling off' period for 'short term' loans.

Credit Corp also recommends the introduction of a 4% monthly flat rate cash loan as an equivalent to the Review's recommended cap for consumer leases (Recommendation 11). This will feature all the same controls as those recommended in the Review for consumer leases. This product will be designated as a 'consumer lease equivalent loan' and will not attract the term 'payday loan'.

This new loan type will:

- limit the potential for the use of inflated RRPs in calculating repayments;
- provide a competing alternative for consumer lease consumers;
- provide consumers with the ability to shop around for the cheapest and most suitable appliance;
- create a much cheaper loan product as an alternative for existing SACC consumers; and
- stimulate competition with the SACC segment by providing for the entry of mainstream operators without attracting the stigma associated with pejorative language such as 'payday loan' to their products.