Response to the Final Report of the

REVIEW OF THE SMALL AMOUNT CREDIT CONTRACT LAWS

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To: Consumer Credit
The Treasury

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PART A: GENERAL COMMENTS AND OBSERVATIONS

The Panel shows concern that financial inclusion should include access to finance "*irrespective of cost*". This is a laudable sentiment, but unfortunately it doesn't recognise that services in a private market generally come with a cost; and that cost is driven upwards by an onerous regulatory regime. It is all well and good to espouse that consumers shouldn't be faced with levels of cost which "*risk that consumers may be unable to pay for basic needs or default on other necessary commitments",* but you can't expect service providers to cope with a complicated set of compliance rules without seeing their costs rise. Add to that a rather toothless array of enforcement options and an un-researched cap on gross profits. That's how you get the debacle which SACC lenders currently face.

The Panel wants to make it worse. The recommendations in the Final Report relating to SACCs fall into two broad categories:

- Recommendations which have zero effect on the way SACC lenders who are doing the 'right' thing operate; and
- Recommendations which have the propensity to severely damage an already crippled industry.

These factors conjoined make the Final Report an unwarranted threat of punishment for the conscionable SACC lender.

Since the introduction of the SACC regime, we have been trying to hang on in, the hope that the promised Review would shine some sense on the state of the industry. Alas, it does not. Since the inception of SACCs we have:

- Seen our representatives close all their physical offices;
- Terminated the engagements of eight representatives (including one in the past week); and
- Made half our administration staff redundant,

done in order to reduce expenditure levels in the face of increased costs and reduced profitability.

Further cuts are being considered. This is problematic as SACC loans are particularly labour intensive. Our usual consumer is not a sophisticated borrower, and often lacks a technical understanding of financial products (let alone the peculiarities of SACCs).

It incenses us when uninformed comments are made about SACC lenders which imply they enjoy some inordinate measure of profitability. For example, the Panel makes the statement at page 7 of the Final Report:

"*The Panel considers that the existing concessional cap on costs for SACCs is appropriate provided that the responsible lending obligation changes are implemented, although the Panel would encourage industry to view it as a cap not a floor.*"

The 'concessional cap' is not appropriate. It is insufficient to allow lenders to achieve a reasonable return. It's a 'floor' instead of a 'cap' because there's no capacity for going below it without making a loss on the product.

That any group can blithely claim that SACC lenders are profitable when they have no data (at worst) or are trying to compare all lenders to publicly listed corporations (at best), is galling. Whether it's wanton ignorance, the misrepresentative slur of annualised cost figures or some other reason - we're not sure.

It is clear that whoever is ultimately making the decisions about the fate of our industry either does not know the truth or does not want to know the truth. And the truth is: if you pay peanuts, you get monkeys. You cannot expect businesses to operate within a complex, punitive regulatory regime, performing work which is risky (both in terms of penalties for non-compliance and difficulty in enforcement) and expect them to survive on insufficient reward.

Table 6 of the Final Report

Special comment must be made about the information portrayed in the Final Report at pages 25 and 26, through Table 6. Table 6 proclaims itself to be a translation of SACC fees and charges into an annual percentage rate ("APR"). We expected better from the Panel, given their credentials and experience.

The expression of SACC costs as an annualised percentage is wrong and in any case, even if it was a suitable expression, each annualised rate figure presented in Table 6 of the Final Report is either misrepresentative (at best) or incorrect. Our reasoning is:

(a) APRs are predicated on the money being owed for terms in multiples of years. Of the examples used, only one is a multiple of a year (and that multiple is '1'; hardly compelling). Therefore, any term of less than a year must be subjected to a multiplying factor to achieve an answer. This factor means the fact the debt is owed for only a fraction of a year is neglected, as the formula commonly used for annualising percentage rates is unable to factor in the irrelevant period when no amount is owed.

To explain this concept in simple terms, it’s like looking at an ant under a microscope and proclaiming that giant monsters are invading. Just as ants cannot get as big as they appear under a microscope, SACCs are limited in the amount that they can grow to. It is wrong to express them in larger than life terms;

(b) Despite having the same fee cap, the table shows a 238% range in outcomes - indicative of the calculation’s lack of suitability for providing information about cost, and highlighting (a)'s concepts;

(c) APR calculations require the use of a compounding factor, as standard credit products charge interest by reference to the amount owing and unpaid fees and interest are capitalised. This is not the basis on which SACCs are permitted. It is especially dangerous given when conjoined with the concerns about expression referred to in (a) above.

While compounding works 'both ways', SACCs severely suffer when it comes to APR calculations. If a SACC is not paid, its monthly fee becomes a smaller proportion of the amount outstanding the longer the debt exists (until it disappears altogether, because 20 monthly fee iterations is the maximum number if the full 4% is charged). This table shows the progression:

Table 1: Actual monthly return on SACCs

Amount of loan:	$500	**Establishment fee:**	$100 (**20%**)
Monthly fee:	$20 (**4%**)		
Month	**Balance Owing**	**Monthly fee**	**Actual Monthly (% of balance)**
1	$620	$20	3.23%
2	$640	$20	3.13%
3	$660	$20	3.03%
4	$680	$20	2.94%
5	$700	$20	2.86%
6	$720	$20	2.78%
7	$740	$20	2.70%
8	$760	$20	2.63%
9	$780	$20	2.56%
10	$800	$20	2.50%
11	$820	$20	2.44%
12	$840	$20	2.38%

Were the table to continue on, the 'Actual Monthly %' would decrease until month 21, at which point it would become 0% and remain there forever.

Before writing off the above example as unrealistic, in the last 12 months we have written off:

(i) 64 SACCs where no part of the principal was repaid by the consumer, representing principal of over $70,000; of which

(ii) 14 SACCs had no repayments made on them whatsoever,

and we have never had a consumer who has paid the establishment fee upfront (because it is not logical to do so);

(d) The 'annual percentage rate' in the Final Report's table increases while the 'maximum amount payable under a SACC' decreases. Given that each loan has the same principal and repayment cycle, this juxtaposition is misleading and counter-intuitive.

For example: if the three terms shown are presented to a consumer, who is asked to picked the cheapest loan, their answer will differ depending on whether they are asked to choose from the total dollar cost or the percentage rate. That the lowest interest rate corresponds with the highest dollar cost demonstrates the annual percentage rate is not an appropriate measure for SACCs;

(e) The maximum amount that can charged on a SACC in any 12 month period (for the purposes of a cost calculation) is 68% of the principal - 20% establishment fee plus 12 lots of 4% monthly fees. Further, SACCs are uniquely subjected to a total cost of credit cap. The maximum amount that may be charged (inclusive of default fees) is 100% of the principal.

When the maximum charges are 68% (for 12 months) and 100% (ever), it is plainly misrepresentative and ultimately confusing to consumers to use percentages rates which imply much greater cost; and

(f) While we maintain annualising the charges is unsuitable (and accepting the Final Report does not disclose the formula used for the calculation), it appears the figures given in Table 6 of the Final Report are either incorrect or, at best, one possible interpretation from a range.

We have calculated the figures based on the information provided and using the 'annual cost rate' formula appearing at section 32B of the Code:

Table 2: Re-interpretation of Final Report's Table 6 annualised rates for SACCs*

SACC term	Maximum amount payable (incl. principal)	Fortnightly repayment amount	Calculated rate	Difference from Report
6 weeks	$640	$213.33	337.32%	**-12.68%**
3 months	$660	$110	209.31%	**-13.69%**
12 months	$840	$32.31	95.62%	**-16.38%**

Again, we do not accept the legitimacy of annualising the charges on SACCs. The information in the above table is only made for comparison against Table 6 of the Final Report to demonstrate such a calculation is unsuitable for interpreting SACCs.

We do not accept the APRs shown in Table 2 to be any more representative of the true cost of a SACC than any other expression of an APR. However, the table serves to clearly show that a significant variance in answers can be provided from one calculation - rendering APR an unreliable representation of cost for SACCs.

PART B: RESPONSES TO RECOMMENDATIONS

Recommendation 1: Affordability

Extend the protected earnings amount regulation to cover SACCs provided to all consumers.

Reduce the cap on the income usable for all SACC repayments to 10 per cent of the consumer's net income.

Subject to these, retain the existing establishment and monthly fee caps.

While we appreciate the Panel's reasoning for the mechanism of this recommendation (particularly when recommendation two is factored), extending the protected earnings amount to 10% on all SACCs is simply too restrictive. The rationale of encouraging longer terms in order to ensure "*smaller and more affordable fortnightly repayments*" is also flawed. We doubt the outcomes are in line with what is desired.

These issues arise:

(a) **Consumers who can demonstrate an ability to afford repayments above the 10% will be unfairly prejudiced**.

The SACC provisions are founded on ensuring the consumer is able to repay the loan without 'substantial hardship'. The well known vagueness of the term 'substantial hardship' aside, a compliant lender will ensure repayments are affordable for the consumer. Doing otherwise is obviously counterproductive, as unaffordable loans do not get repaid (aside from potential civil and criminal liability).

If a lender is not compliant, sufficient powers exist in the legislation to redress their conduct - not least of which is the external dispute resolution requirement which offers consumers an easy, free and binding decision against the lender.

If a consumer can demonstrate the ability to service a loan with repayments greater than 10% of their income (but are restricted nonetheless), they will either be forced to consider a smaller loan or a longer term. A smaller loan may fail the 'requirements and objectives' suitability criteria under the Act. A longer term incurs some of the issues set out in this response. If neither is what the consumer wants or needs, they may be forced to take an unsuitable loan;

(b) **The restriction may impinge the loan amounts notionally available to the consumer.**

For the purposes of this section, it is important to realise that almost every SACC lender charges the maximum allowable establishment and monthly fees permitted at law. We do not see that changing, because the returns allowed under the current cap are insufficient for lenders to remain economically viable.

The SACC regime has a finite range, with a maximum principal of $2,000 and a maximum term of 12 months. Most SACC lenders operate significantly less than either maximum.

We provide SACCs of up to $2,000 on repayment terms of nine months; which is well above the average amount and term for most SACCs. The repayment amount for a $2,000 loan on a nine month repayment term calculates at $170.00 per fortnight.

If we accept, for the sake of argument only, the income figure for the average SACC consumer is $1,219.00 per fortnight[1] then the average consumer will not be able to obtain a SACC for the maximum amount available (if the 10% maximum is implemented).

It further appears that the 'average' earner cannot even obtain a $2,000 SACC if it is taken over a 12 month repayment term (repayments of $129.00 a fortnight).

It would therefore appear that the Panel's suggestion either precludes the average SACC consumer from being able to obtain the full range of SACC loans available, or surreptitiously seeks to force SACC lenders to lower their fees below the legislated (albeit still insufficient) maximums.

(c) **Longer term loans are more expensive to the consumer**.

While the Panel may seek to advocate longer term loans for consumers, the Final Report effectively ignores that this carries a liability to the consumer. The longer the term of the SACC, the more fees the consumer will pay.

To illustrate this, we revisit the information in the Tables 4 and 5 of the Final Report to show the difference in fees payable as the term is extended:

Table 3: Increase in SACC fees by extension of term

Loan Amount	Fees payable for 3 month term	6 month term vs 3 month term	9 month term vs 3 month term	12 month term vs 3 month term
$500	$160.00	Extra $60.00	Extra $120.00	Extra $180.00
$1,000	$120.00	Extra $120.00	Extra $240.00	Extra $360.00

It seems disingenuous to complain about the total cost of SACCs loans to consumers on one hand, but then advocate actions which can have the effect of costing the consumer up to three times as much in fees and charges.

(d) **Longer term loans may be more risky for the lender**.

SACC lenders almost universally operate on repayment terms of less than the 12 month maximum. The vast majority appear to operate on terms of significantly less than half that.

The longer a loan exists for, the greater risk the lender must endure because of the inherent issues in SACC loans. Most particularly:

(i) (As with the majority of loans) Longer terms mean a longer period before the lender may recoup their capital. Many SACC lenders are small businesses. Their operating capital comes from internal sources, often underpinned by some form of personal guarantee from the operator/company director. Effectively, each failed SACC loan potentially jeopardises the family home of the people behind that business - which possibility seems all but forgotten by legislators;

(ii) Like most small businesses, the majority of SACC lenders rely on cash flow to continue operation. Longer term loans mean smaller repayments. While seen as somewhat positive for the consumer, the other side of the coin is that lender cash flow is constrained. With this occurring, the ability to fund running costs and further lending becomes more difficult;

[1] Per Tables 4 and 5 of the Panel's Final Report, at pages 17 and 18; noting that we do not necessarily accept the credibility of Digital Finance Analytics' report given the reportedly serious concerns raised with the Panel as to its methodology and information base.

(iii) Security cannot be taken, which is a major failing in the product. As a lender who predominantly operates at the larger end of the SACC spectrum (our average adjusted credit amount on SACC products is $1,100), the inability to take security has greatly increased our risk profile. We now have no collateral for our risk beyond a simple promise to pay; and

(iv) The consumer base for SACCs is often portrayed as having a low degree of financial literacy. Unfortunately, this appears to have some credence to it. In our experience, a significant portion of borrowers show little to no regard for their responsibilities under their loan contracts. When this is coupled with extended terms (particularly in light of comment (ii) above), we see that these borrowers have a tendency to dishonour repayment obligations, become unresponsive, dismissive or aggressive and, in a significant number of cases, simply disappear completely, unable to be contacted. We find the longer a loan exists, the greater the chance of such events occurring;

(e) **The restriction may unfairly constrain consumers who have a need to access a SACC for emergency purposes** (especially those who take a SACC at higher repayments in order to reduce its term).

An absolute prohibition on a consumer committing any more than 10% of their net income to SACC repayments has the potential to cut that person off from quick, responsive funding in the case of an emergency.

If that person is unable to source funds despite being able to demonstrate the capacity to meet the financial obligations, who is going to help them today? Not in a few days, or next week, or next month - <u>today</u>.

(f) **If the restriction is to apply to the whole of the term of the loan, consumers who are willing and able to accelerate repayments may be constrained from doing so.**

As a SACC lender who has longer terms, this is a situation we see almost constantly. Consumers, for whatever reason, want to increase their repayments in order the clear the loan quicker. Sometimes it's a new job, or a decrease in expenses (such as another loan being paid off). Sometimes it's even a family member contributing for personal reasons. Whatever the reason, unless the restriction is carefully drafted there remains the possibility that the repayments for the loan can never rise above 10% of the borrower's net income.

Likewise, what of the opposite situation? What if the consumer's working hours are reduced, or they lose their job. Is the SACC lender expected to constantly monitor that consumer's income levels are adjust their repayments accordingly? If the response is 'yes', it is patently ludicrous. The lender would be irrevocably tied to the fortunes of the consumer - which matter is completely outside their control.

As an addendum, we are also concerned that we (and other lenders) will have to endure the backlash from consumers when they are told they must take a longer loan so the repayments fit under the 10% limit. Since this will mean the consumer will have to pay more in fees, they may perceive the act as a cash grab by the lender. We know from past experience that the response "it's a government regulation" simply doesn't wash with the customer.

Recommendation 2: Suitability
Remove the rebuttable presumption on unsuitability, on the condition that recommendation 1 is implemented.

Given the Panel's expression that this recommendation should only be implemented if recommendation 1 is as well, we refer to our comments above.

Of particular relevance here, however, we see the recommendation to remove the rebuttable presumption as an acknowledgment that the presumption is a failure. We agree it has failed, and perceive the causes as:

(a) the presumption mechanism was framed in a manner which made it ineffectual; and
(b) the regulator failed to enforce it in any meaningful way (for reasons possibly connected with (a))

If the rules were more clearly created and properly policed, this sort of change would not be necessary.

Recommendation 3: Short term credit contracts

Maintain the existing ban on credit contracts with terms less than 15 days.

We note this is recommendation has almost universal support amongst all stakeholders.

We further point out that, despite what media, consumer advocates and regulators may peddle, this prohibition means that SACCs are not 'payday loans'.

Recommendation 4: Direct debit fees

Direct debit fees should be incorporated into the existing SACC fee cap.

The Panel states their recommendation is consistent with the intention to restrict the debtor's liability under a SACC. Be that as it may, the intention that the cap was to allow a sufficient return for SACC providers to remain viable has also been repeatedly proclaimed. We state, again, the existing 20/4 cap is insufficient to allow a reasonable return for lenders. Making direct debit charges a part of that cap will greatly increase that strain.

There has been no economic modelling done to date on the profitability of SACC loans, or on the impact on profitability this proposed recommendation would cause. This is a serious, fatal flaw underpinning the Final Report's recommendations, which cannot conscionably be ignored.

The vast majority of our loan repayments are made via direct debit transactions. This is our preferred method, and it appears to us to be the preferred method for our borrowers.

Our responsible manager has been in the small amount credit market since before direct debiting became available. At that time, the methods of payment available were direct deposit into the lender's bank account (at the bank) or payment in cash. These methods were burdens for both parties; consumers had to take the time to physically attend and make the payment, and lenders either had cash handling concerns or had to spend time tracking individual bank account entries for entry against debt ledgers.

The availability of electronic payment methods, such as BPAY and electronic direct deposit, obviously add further flexibility - but still endure problems. Both of these payment methods require ongoing, positive actions by the consumer to be done, and may still require debt ledger tracking. In our experience this inconveniences consumers, the former because it makes the prospect of payment less likely (whether on time or at all) and the latter can involve delays in repayments being credited against a debt.

The SACC cap included direct debit fees within the 20/4 cap on initial announcement. On 17 August, 2012 we wrote to Treasury (as some others did at the time) expressing concern about the economic effect of this. Our concerns are no less, and no different in nature, today.

As we pointed out to Treasury in our letter, we do not have our own direct debit facility, and cannot obtain one from our bank. Our understanding is none of the major Australian banks are willing to provide such facilities to SACC lenders, and we point to the wider reports of Australian banks revoking all services to SACC lenders in this regard. Accordingly, we must rely on the services of a third party provider and all direct debit fees are hard costs to us if we must incur them.

Our direct debit service provider charges $2.00 per direct debit draw. Since our average SACC is calculated on a 9 month repayment period, provided all repayments are made on time without alteration:

(i) Weekly repayment loans have 37 repayments, costing a total of $74.00 in direct debit fees; and

(ii) Fortnightly repayment loans have 19 repayments, costing a total of $38.00 in direct debit fees.

Consumers may nominate their preferred repayment cycle, with fortnightly repayments occurring in 66% of loans.

If a direct debit draw is not successful, our service provider charges a $14.50 fee. This may more properly described as a default fee, and is completely beyond our control. There is no fee payable (either to us or to our direct debit service provider) if a customer reschedules a repayment before it is processed.

To demonstrate the effect of including direct debit fees in the 20/4 cap, assuming all repayments are made as they fall due:

1. The maximum return on a $500 SACC is 4% per month ($20);

2. However since the return is actually $20 on $620 (because the establishment fee is universally financed and the first month's fees are incurred) the return is actually less. $20 return on $620 (principal plus establishment fee) is 3.23% per month;

3. This return decreases if the cost of DDR fees must be absorbed in the monthly fee. If so, we get:

   - Weekly repayments: $20 - (4 x $2) = $12; or
   - Fortnightly repayments: $20 - (2 x $2) = $16; and

4. Recalculated returns are:

   - $12 / $620 = 1.935% per month (weekly repayments); or
   - $16 / $620 = 2.58% per month (fortnightly repayments).

   These returns further decrease if repayments are not made and the outstanding balance rises.

Therefore, even if a consumer makes all scheduled repayments, the lender's gross return is as little as half of what the legislation provides for. If repayments are made fortnightly, it is little better.

The truth of the matter is, however, that not all consumers make their promised payments.

Based on current rates of processing, we anticipate that 15,250 direct debit draws will be made against SACC loans in this calendar year. If we are required to factor this expense into our returns, this equates to an extra annual cost to us of $30,502.

Currently 16.94% of all direct debit draws attempted dishonour. This means another $35,900 when factoring unsuccessful draw fees (for a projected total cost of $66,402).

This dishonour rate means that an average loan for us expands from 19 repayments to 23. The all up cost rises from $38 to $104 ($46 in DDR draw fees and $58 in dishonour fees). We again point out that whether a DDR honours or dishonours is beyond our control, resting with the consumer.

Accepting the SACC establishment fee is supposed to cover the cost of establishing a loan (which is doesn't, per our previous submissions) and that our average loan term is 9 months, we project the following:

Table 4: Projected effect on gross return by inclusion of DDR fees in SACCs cost cap*

SACC 'principal'	Gross return (4% x 9mths)	Return ($) after factoring DDR costs	Decrease in total gross return
$100	$36	-$68	-104.00%
$200	$72	-$32	-52.00%
$300	$108	$4	-34.67%
$400	$144	$40	-26.00%
$500	$180	$76	-20.80%
$600	$216	$112	-17.33%
$700	$252	$148	-14.86%
$800	$288	$184	-13.00%
$900	$324	$220	-11.56%
$1,000	$360	$256	-10.40%

$1,100	$396	$292	-9.45%
$1,200	$432	$328	-8.67%
$1,300	$468	$364	-8.00%
$1,400	$504	$400	-7.43%
$1,500	$540	$436	-6.93%
$1,600	$576	$472	-6.50%
$1,700	$612	$508	-6.12%
$1,800	$648	$544	-5.78%
$1,900	$684	$580	-5.47%
$2,000	$720	$616	-5.20%

Table 4 assumes that despite dishonouring, the consumer will go on to pay and clear the loan. Unfortunately, we cannot report that this is the case and therefore these figures represent an unrealistic model - the reality is worse.

While we are not prepared to publicly share our company's financials, we can share that the added expense from having to absorb DDR fees will make us unviable (even using the more favourable factors assumed in Table 4).

The Panel's recommendation is therefore simply unsustainable. That the Panel has made such a recommendation clearly shows that no suitable economic modelling has been undertaken (if any has been done at all).

Recommendation 5: Equal repayments and sanctions

SACCs must have equal repayments over the life of the loan.

We support this recommendation, provided sufficient flexibility is given to ensure that lenders and consumers are not arbitrarily locked into set repayments that cannot be amended during the course of the loan in response to unforeseen occurrences.

Recommendation 6: SACC database

A national database of SACCs should not be introduced at this stage.

We make no comment about the question of the SACC database, as the Panel's recommendation broadly aligns with our previously expressed sentiment.

However, we wish to draw attention to comments made on page 30 of the Final Report:

"*The Panel considers that the CCR [*Comprehensive Credit Reporting*] regime could be a suitable alternative to a national SACC database, but appreciates further time is required for this regime to be implemented.*

The CCR regime has only been in place for a relatively short period of time and the major banks are still in the process of deciding whether to participate in the regime."

Our first submission to the Review gives five reasons why CCR is not viable:

(a) It's complex;
(b) Credit reporting in Australia is fractured;
(c) Infrastructure necessary to participate will be expensive;
(d) The cost of actually participating as against realisable returns on SACCs; and
(e) Increased compliance difficulties.

These concerns are in no way abated, or ameliorated. Without substantial overhaul it is not foreseeable that they will, either.

That the major banks are "*still in the process of deciding whether to participate in the regime"* is concerning.

The revelation that the Australian Retail Credit Association ("ARCA") was a major participant in the development of the CCR and is "*committed to assisting the development of a compliance framework for comprehensive credit reporting (CCR) environment..."* makes the banks' non-participation positively alarming – because the major banks are all members of ARCA.

Recommendation 7: Early repayment

No 4 per cent monthly fee can be charged for a month after the SACC is discharged by its early repayment.

This should not have to be a recommendation - it should already be covered in the legislation.

Our only comment is that any provisions to accomplish this be drafted with care to ensure lenders' returns are not unfairly truncated by further inexact drafting.

Recommendation 8: Unsolicited offers

SACC providers should be prevented from making unsolicited SACC offers to current or previous consumers.

We have no disagreement 'in principle' with the intention behind this recommendation, but are reticent to support it in the fear that its implementation would be overbearing.

A large part of our disquiet with this recommendation is that it was not a matter raised in either of the two consultation papers. In our view, this has denied SACC lenders the opportunity to make adequate submissions on the subject.

A further concern is the Panel has sought to predicate this recommendation using (in part) a case study given by the Consumer Action Law Centre ("CALC"). CALC has an unfortunate propensity to misrepresent matters of fact, ostensibly to further their own agenda. We note the referenced example is referred to by CALC as *"We have also seen examples of payday lenders text messaging clients asking them to return"* [sic].

Given CALC's notoriety we have no confidence that this example necessarily relates to a SACC loan. For example, they:

(a) Do not state when the matter occurred (or even give any approximation, such as 'recently'). Consumer advocates are notorious for dredging up examples of conduct from previous regulatory regimes, which have no relevance to current issues, and presenting it as current and relevant. We have no confidence that a similar act hasn't occurred here; and

(b) Use the pejorative term 'payday loan' when referring to the matter. The use of this malappropriated term could easily hide that the loan referred to in the case study is not, in fact, a SACC. By refusing to use the correct terminology, CALC could easily rely on the reader's assumption that they are referring to a SACC when they use the misnomer 'payday loan'.

To follow through with the situation (assuming it is actually relevant), it is entirely possible that already existing provisions in the Act may be sufficient to counter this type of behaviour in any case:

(i) Offering a new loan without complying with the requirement to make a proper credit assessment is an obvious breach of the Act; and

(ii) If the offer occurs more than 90 days from the date on which the immediately previous assessment was made, then that previous assessment cannot be relied on (as they have a maximum 'life' of 90 days). Further, even if it was the case that it occurred within the 90 day period, it could be easily addressed by reducing that timeframe to a more reasonable period.

However, if the recommendation is taken up for legislating we urge that care be taken so as to not inadvertently capture any form of innocuous contact by a SACC lender which may be maliciously construed as an 'unsolicited offer'.

Recommendation 9: Referrals to other SACC providers SACC providers should not receive a payment or any other benefit for a referral made to another SACC provider.

We have no knowledge of such activity occurring at all, and certainly not to the degree intimated by the Financial Rights Legal Centre. To be frank, we fail to see how any lender who is complying with the regulatory requirements could hope to pay for lead generation and enjoy any sort of profit margin.

Regardless, this supposed practice appears to be unfairly characterised in the Panel's report; with the following considerations apparently ignored:

(i) Any fee paid for lead generation must necessarily be absorbed by the lender because of the SACC cost cap. Accordingly, the consumer does not pay for the referral;

(ii) The consumer obviously seeks financial accommodation. If they are rejected by one lender, giving another lender an opportunity to respond to their application actually makes sense. There is little objective difference between referring a lead and the consumer initially contracting a broker to seek finance on their behalf.

This sentiment must be viewed in terms of the other points made here, and not in isolation; and

(iii) Any loan the consumer receives must necessarily be made in accordance with the responsible lending obligations. This is a fundamental, inescapable requirement.

We do not see the point of adding additional regulatory requirements to an already overburdened system, when those further requirements have no benefit to consumers and the 'evil' that they are trying to negate is already adequately catered for.

Recommendation 10: Default fees

SACC providers should only be permitted to charge a default fee that represents their actual costs arising from a consumer defaulting on a SACC up to a maximum of $10 per week.

In this part, it is first worth acknowledging that certain sections of the Code act to restrict the amounts that lenders can recover on default:

- **Section 39B**, which limits the total amount recoverable under a SACC;
- **Section 78**, which gives powers to the court to annul or reduce charges (which power therefore arguably extends to external dispute resolution scheme providers); and
- **Section 107**, which prohibits lenders from recovering more than they reasonably incur in enforcement expenses.

Our response to this recommendation comprises three parts:

1. <u>Comment on the reasoning behind the recommendation</u>

There is a clear dichotomy in thinking by the Panel in this area:

(a) On one hand the Panel claims an objective is to "*continue to provide SACC providers with the ability to recoup reasonable costs incurred on default*"; however

(b) It is recommended that the maximum amount allowable on default be $10 per week.

There is absolutely no reconciliation of these concepts, and it is clear there is little to no understanding of the actual costs involved. There appears to be no realistic rationale for the suggested $10 per week figure, either.

The first indication of the $10 figure was in the Panel's Interim Report, released in December 2015, where it was an example figure in Option 5 on page 17. This example appears to have been latched onto by consumer advocates.

The Final Report attributes some submissions with "*suggesting a default fee cap of $10 a week*"[2]. In one of the submissions referenced as making the 'suggestion', Consumer Action Law Centre refers to Option 5 in the Interim Report and states that it "*supports a $10 per week cap, as this sets a bright line rule, and would inhibit the various different approaches taken by SACC providers.*"

In other words, the advocates are saying they support the Panel's $10 figure while the Panel claims it was the advocates who suggested the figure! And nowhere in that roundabout reasoning is any justification for the figure at all. And even if the advocates had suggested the figure to start with, there is no credible reason why the Panel should believe the representations of a non-profit organisation, who are anti-lender and do not operate in the market, as to how much it costs a lender to administer a loan in default. They simply wouldn't know, and likely don't care.

It is also concerning that the recommendation appears to make no differentiation between internal and external costs. How far is the cap expected to extend? It is one thing to tell a SACC lender how much they can charge for production of a letter. But what if the lender's direct debit service provider requires payment of a fee on dishonour? And what of the fee the consumer may be charged by their bank? Is the lender expected to be responsible for these? The lender is not in control of the last two, and they will quickly exceed the recommended cap if required to pay them. So, if lenders must fit these fees in under their allowable cap, where does the rationale of allowing SACC lenders to recoup their reasonable costs fit in? How will lenders be

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[2] At page 41.

provided with some modicum of control over the incidence of default, and the reasonableness of the fee charged by the third parties? And, since the lender will be required to bear the cost of something that is not their fault if this recommendation comes to bear, how is any of this fair at all?

For example, our direct debit service provider charges $16.50 per dishonoured payment (including draw attempt fee) - which already exceeds the $10 cap proposed. What then? Are we expected to be unable to recoup any of our own expenses for administering the default, and still potentially have to pay another $6.50 to our service provider (and then possibly whatever fee the consumer may incur from their bank)? Is it really expected that we will work for nothing, and pay for the privilege of doing so?

The Final Report states the Panel received information from stakeholders about the costs incurred on default:

(i) ASIC's submission to the Interim Report disclosed a range of fees charged by a sample of lenders, the majority of which exceeded $10 per week;

(ii) Our submission was referenced as one of those which "*highlighted the high costs associated with default*"; and

(iii) Representations were made to the Panel by and on behalf of SACC providers that default fees "*of around $30-$35"* were being charged, and that "*average default costs were around $35*".

We keenly note none of these representations were disagreed with or called into question by the Panel in any way whatsoever. Yet, despite this and the Panel's statement that it "*was not controversial across consultations that SACC providers should be able to recover their reasonable costs of default"*, the recommendation of $10 per week was still made. The Panel even has the audacity to claim "*this cap strikes the right balance of allowing SACC providers to recoup their reasonable costs while preventing the quick escalation of fees."*

It is indeed interesting the Panel has simply taken the consumer advocates' stance, given there is no indication that any research or economic modelling has been conducted by the Panel to verify either side's claims. We question what reasonable basis such a finding may be based on.

Accordingly, we emphatically reject the Panel's recommendation as having no basis in reality.

It is completely unsubstantiated, and is dismissive of representations by a range of informed stakeholders while falsely attributing the $10 figure as being suggested by pro-consumer groups - who by their own acknowledgment wish to see the eradication of the industry.

The cost of properly administering a default is much greater than $10. Forcing lenders to charge less than what it costs them is deplorable: especially for an act which is beyond the lender's control.

2. <u>The costs of administering defaults in SACCs</u>

The information provided by industry minded stakeholders about the costs incurred by lenders when consumers default on their SACCs is discussed above. It is strange that a number of separate parties have indicated that costs on default run to around the $35 mark, yet the Panel has seen fit to recommend $10 as the limit without any evidence to support their contention. We could easily be forgiven for thinking the recommendation is less about allowing lenders to recoup costs for acts of parties beyond their control, and more about falsely punishing lenders in the name of consumer protection.

To underpin our following comments, we have three full time representatives solely working on collections and one representative part time. These representatives administer over 1,000 loan contracts between them, at practical capacity. Their employment costs over $170,000 per annum (including superannuation and leave entitlements, but not including items such as mandatory training).

In addition to the representatives, our responsible manager spends a significant part of his time providing compliance supervision, document creation and backend support in respect of collections. As stated in our initial submission to the Panel, our responsible manager is not paid for his work in the role. However, employment expenses for such a position are estimated to be at least $75,000 per annum. Easily 40 – 50% of his time is spent in a collections capacity.

Next, we apply two broad categories to credit contracts which are delinquent: 'doubtful debts' and 'bad debts', based on their particular circumstances:

(a) Some examples of what characterises 'doubtful debts' are:
   (i) No repayments received in excess of 30 days;
   (ii) We have no current means of making contact with the consumer;
   (iii) There is no current repayment proposal for the loan;
   (iv) Monthly fees have expired or been reduced/removed from the loan; and
   (v) The consumer has clearly indicated (by words or conduct) an intention not to repay the loan; and

(b) Some examples of what characterises 'bad debts' are:
   (i) The consumer has become bankrupt under Part X of the *Bankruptcy Act 1986 (Cth);*
   (ii) The consumer has been listed as a serious credit infringement with a credit reporting body (basically meaning a default listing has been made on their credit file and no contact with the consumer has been achieved in at least 6 months);
   (iii) The consumer is deceased; and
   (iv) The loan was obtained by fraud.

Collectively, we refer to doubtful debts and bad debts as 'impaired'. Our impairment currently runs in the vicinity of 30% of our loan book (based on dollar figures).

We acknowledge some of these loans may ultimately be repaid. This is only a partial consolation, however, as:

- It takes time to achieve that result, which time negatively impacts cash flow and the ability to continue trading;

- As shown above, we must expend significant money in wages to chase payment; and

- Repayment is often at a discounted rate, most notably caused by the SACC cost cap being reached or fees and charges being reduced/removed to encourage payment.

The ultimate result is that we receive less return on these loans (if at all), and must wait longer for it.

To illustrate this in practical terms, consider our oldest impaired SACC:

- Given on 16 July, 2013, with an adjusted credit amount of $1,000;

- The consumer was employed in a full time position, having been employed for over a year at the time of application;

- On assessment, the consumer's financial situation was such that they could make the contracted repayments on the loan and still have a significant 'buffer';

- The consumer made the first two repayments on the loan by direct debit;

- The following two repayments were dishonoured;

- We were unable to make contact with the consumer, who failed to respond to telephone messages left to make contact;

- The direct debit on the loan was turned off on the second dishonour, as is required by the legislation. We were prohibited from further payment draw attempts;

- We succeeded in contacting an account reference (next of kin), who informed us the consumer had lost their job and 'couldn't face their debts'. The reference was unable or unwilling to provide contact details for the consumer, and requested that we make no further contact with them; and

- Section 88 notices sent to the consumer at their residential address were returned, with the notation "moved".

This loan was deemed impaired on 30 September, 2013. To date, it has not been paid. We have had no contact from the consumer, and have been unable to locate them. The outstanding balance on the loan is $1,470 (which doesn't include 10 lots of monthly fees which we are entitled to charge, but haven't). We did not receive sufficient repayments to cover the establishment fee. We have received no part of the principal. The consumer has been unreachable for over two and a half years.

This example is in no way unique, and was not 'handpicked' for its circumstances. It is simply, as stated, the first SACC on our list of impaired loans.

If the government is serious about enabling lenders to fairly recoup their expenses for loans which go into default, we invite (nay, implore) them to actually look at the facts and circumstances of what SACC lenders are facing; to see the reality of things.

Of course, if they are not we kindly ask that false platitudes to such illusions be removed.

3. <u>Legislative issues still need to be overcome</u>

We highlighted in our response to the Panel's Interim Report some of the issues caused by the treatment of the term 'default' in the Code, which it does not define. It also does not define 'enforcement' (or provide particular assistance through the definition of 'enforcement expenses'). Nor does it satisfactorily deal with the relationship between the two concepts.

Before the advent of SACCs, this would not have proved especially problematic. In simple terms, one leads to the other – you don't enforce a contract which is not in default.

The SACC provisions make it a problem though, due to the cap. Default charges are included in the cap, while enforcement charges are not. Some of the actions which flow from an act of default form a necessary part of the enforcement process. Now, the determination of the line between the two becomes relevant.

The best way to explain the notion is by example, ant the most obvious is the section 88 notice. This Code section requires that a notice informing the consumer of an act of default under the credit contract must be sent before enforcement proceedings can begin, giving the consumer 30 days to remedy the situation. It is a necessary step, as enforcement proceedings cannot be started until the notice has been given, the 30 days has expired and the consumer has not remedied the default.

Although called a 'default notice', especially since subsection 88(3) requires the notice must prominently state "default notice" at its top, it is more properly characterised as an 'enforcement notice'.

By its very nature, it must be completed before enforcement can take place. Its expenditure must be met out of an act of default, but the charge for the notice is not as much a fee charged for an act of default as it is a charge incurred for a necessary part of the enforcement of the contract.

Despite this, the importance of the division is obviously missed by many, including the regulator. ASIC's response to the Interim Report includes information about the 'default fees' of some lenders (included in the Final Report as Table 7 on page 39). In this information, ASIC lists a default fee item as 'default notice/letter fee'. Perhaps it is the legislated misnomer which has triggered this slip up. Or perhaps it is because, until recently, the difference has been seen as largely rhetorical.

The fact is: it is now a different matter because SACC default and enforcement charges are treated in different manners. It becomes necessary to determine what it is for the purposes of the total cost cap.

This will be further complicated if the Panel's recommendation is adopted, as a default fee will be individually capped while enforcement fees will not. We urge the Panel not to create an unworkable situation where lenders are only further forced to lose money by being unable to charge a reasonable amount for the costs incurred due to actions beyond their control.

Recommendations 11 to 18: Consumer leases

We do not provide consumer leases, and make no comment on recommendations 11 to 18.

Recommendation 19: Bank statements

Retain the obligation for SACC providers to obtain and consider 90 days of bank statements before providing a SACC.

Introduce a prohibition on using information obtained from bank statements for purposes other than compliance with responsible lending obligations.

While we note that Final Report refers to our initial submission as supporting retention of the obligation, we are dismayed that the Panel does not appear to have taken into account the problems we raised in respect of the current provisions. Namely:

(a) The 'immediately preceding' requirement to the 90 days, which is inexact, confusing and potentially cumbersome to comply with; and

(b) The regulator's interpretation (as to which accounts should be obtained) appears to exceed what is required by the legislation.

We consider the Final Report's comments that some stakeholders raised concerns as to whether statements were "*actually being used by the SACC provider as part of the assessment of unsuitability"* to be disingenuous. The Final Report refers to two submissions in this respect:

(i) One submission cites concerns that many lenders don't look at the statements very closely, citing ASIC's fatally flawed Report 426 (for reasons set out in our previous submissions). Report 426 simply identified "*instances*" where information conflicted, acknowledged some lenders addressed the conflicting information and did not give any indication of what proportion of lenders were not using the statements. The submission fails to substantiate its claims, rendering it unreliable; and

(ii) The other submission posits *"lenders do not effectively use the information to determine whether advancing a loan is responsible"*, thereafter immediately citing a Federal Circuit Court case in which they are representing a client alleging such conduct. Apart from seeking to generalise conduct across an industry on the basis of one example from one lender (apparently) – that example just so happens to be for a client's court case, and is a matter of allegation (not fact). To see the example as self-serving is an understatement.

We further point out that *"do not effectively use"* is separate and distinct from *"whether it was actually being used"* (as claimed in the Final Report).

Further, it is clear both of these stakeholders have no understanding or experience in the actual workings of SACC lenders by their very nature, and are vehemently committed to the eradication of the SACC industry. As one of the stakeholders states in their initial submission to the Panel:

- "*We are concerned by the premise... that there is a need to ensure the payday lending industry remains viable"* [sic]; and
- "*...we do not agree* [it is] *a useful part of the consumer credit landscape."*

With respect to the use of the information for other purposes, we fail to see how it is not acceptable for a prohibition on using the information without fully informed consent by the consumer (as we submitted, which is partially acknowledged in the Final Report). Ultimately, if taken up for implementation, we look forward to the day when we are required to provide a consumer's bank statements to a third party for a particular purpose and we are prohibited from doing so by law – despite the consumer's written direction.

Recommendation 20: Documenting suitability assessments

Introduce a requirement that SACC providers are required at the time the assessment is made to document in writing their assessment that a proposed contract is suitable.

Our initial submission to the Panel sets out our belief that this recommendation's requirement is already in place (at page 66). To reiterate:

(a) The NCCP Act requires an assessment must be made prior to entering into a credit contract. The totality of the legislative provisions clearly indicates it is expected this assessment will be documented;

(b) The Credit Act gives ASIC power to inspect ‘books’ of a credit licensee in Part 6-3. For the lender to comply with this, and its broader licensing requirements, it must create and retain documentary evidence of its activities. This necessitates a documented suitability assessment;

(c) ASIC Regulatory Guide 209 contemplates that the assessment will be documented; stating “*you must record the assessment in a form that allows you to provide a written copy promptly to the consumer*”[3];

(d) Australian Credit Licences appear to have a standard condition requiring licensees to “*keep a record of all material that forms the basis of an assessment... in a form that will enable the licensee to give the consumer a written copy of the assessment if a request is made...*”[4];

(e) Credit providers are subject to compliance with the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth)*. Part 10 of the AMLCTF Act requires that information relating to designated services must be kept for seven years after it is made. Pursuant to section 6 of the AMLCTF act, making a loan in the course of carrying on a loans business is a designated service; and

(f) Perhaps not of direct application, but various pieces of legislation expect business participants to keep records of their business activities (eg *Corporations Act* and income tax legislation).

We fail to see how a credit licensee can currently be compliant, either in terms of its credit licence or as part of its overall business conduct, without documenting the suitability assessment at the time the assessment is made.

[3] RG 209.87, RG 209.138.

[4] Also contemplated in RG 209 in the note at RG209.138.

Recommendation 21: Warning statements

Provide ASIC with the power to modify the requirements for the statement (including the content and when the warning statement has to be provided) to maximise the impact on consumers.

Before providing our response to the recommendation itself, we wish to draw attention to the Final Report's comments that "[o]*ther submissions considered the warning to be ineffective"*. At the footnote to this statement, our initial submission to the Panel was referred to.

We did not state the warning statement was ineffective. In fact, our submission specifically states (and at the page the Final Report points to):

"... we have no information about the effectiveness of the statements."

In response to the recommendation itself, we are alarmed at the proposal that ASIC be given power over the warning statements in the expectation they *"would seek to maximise the impact of warning statements by making changes, including with respect to content and appearance"*. Certain example considerations were then listed.

We do not share the Panel's optimism that ASIC would make of such power in a constructive or fair manner.

There have been administration issues with the warning statement (notably the requirement to continue referring to a Centrelink telephone number which had been disconnected for some months), but we do not consider the issues at hand have been properly considered.

Consumers are currently exposed to the warning statements before they can apply for a loan (often multiple times). All reasonable approaches to SACC lenders are covered in such a way that a consumer cannot help but have their attention drawn to the warning – often more than once – before they can commence an application for credit.

The warning statement is severely mandated, with strict requirements as to placement, size, font size, wording and accessibility. It encourages the consumer to question their choice to apply for a SACC and to go elsewhere.

The Act's imposes a civil penalty of up to $1.8 million (for corporations) who fail to comply with these strict requirements.

The considerations espoused by the Panel as to why ASIC should be given the power to make ad hoc changes to the warning cause alarm because:

(a) The first consideration smacks of manipulation, while also ignoring the reality of the situation. It's one thing to speak of 'behavioural biases', but the simple fact of the matter is consumers seeking out SACCs have a need to access fast, convenient and available funding in order to satisfy some form of expenditure. Obtaining a SACC is not a behavioural outcome - it's a matter of utilising an available product in response to a pre-existing need;

(b) The warning is already the first port of call when contacting the lender, and must also immediately be presented before any application can be commenced online. Short of somehow providing the warning to someone before they form the decision to apply for SACC, we are not sure how the timing could be improved;

(c) Providing personalised data is problematic for SACCs, to say the least, because of the timing when the warning must be provided. The warning must be given before the consumer ever provides any form of information about the loan they're seeking or their financial position. Put plainly, It is intensely difficult to give someone (who you know nothing about) information which is tailored to their circumstances.

Even if the information is restricted to generalised personal data, the situation is not greatly improved. Considering the sample language provided in the Final Report as an example:

(i) If the warning is somehow perversely interpreted as a form of advertising, presenting repayment information also requires the disclosure of an APR. This is a whole other problem (as set out in our response to recommendation 22);

(ii) Calculation of such statistics is not easily done for small business lenders. To obtain this type of information would necessitate ongoing manual searches across all loans done and a collation of the information. We do not have an automated system capable of making the calculations, because it is simply not necessary, and the cost of implementing one would be onerous;

(iii) What use is the information to any single person in any case? There's no discernible correlation between an imaginary 'average' person and themselves;

(iv) Given the high rate of bad debt we suffer (predominantly because our recovery options have been eroded to almost non-existence, the substantial legislated rights of consumers to evade payment and the inability to take security), we doubt any calculation would give a sensible answer as the number of people who never pay their SACCs would seriously skew the calculation; and

(v) As an aside, we note the example wording "*pays $z in fees and interest"* in the Final Report, and point out SACCs cannot charge interest at all. We cannot seriously believe that due consideration has been given to the matter by the Panel when such a basic, obvious mistake like this has been made; and

(d) We have seen no indication that consumers are unable to process the information without distraction, and don't see how the environment where the warning is provided is any different to the environment where the credit contract is provided. We know of no representation made by any stakeholder that this is an issue, and it has not been raised by the Panel previously.

We are further disquieted by lack of nous shown by ASIC in its regulation of the industry, including:

(i) Massive inconsistencies in its treatment of SACC lenders, shown by a complete failure to take action against the industry's biggest lender despite two major class actions being taken against them in the Federal Court (one of which has already been settled on terms favourable to consumers);

(ii) Inconsistencies in the application of the laws. Breaches of laws about which ASIC has previously taken action against SACC lenders now draw an uninterested response. Further details are set out in our response to recommendation 22;

(iii) Although we have not experienced this first hand, information from reputable sources that ASIC officers are overbearing, dictatorial and condescending, and utterly subjective in their interpretation of the regulations; and

(iv) A readily apparent complete inability to understand the operations of the small business provider in the market.

Recommendation 22: Disclosure Introduce a requirement that SACC providers be required to disclose the cost of their products as an APR.

This recommendation can only be characterised as seeking to placate the interests of consumer advocates - who are mistaken about the requirements of consumers. It must be; because, in truth, they are the only interested parties who appear to have the delusion that 'APR' actually means something when applied to SACCs.

Treasury has long known that SACCs are a 'different animal' to other credit contracts. We have obtained an email from Treasury to the then Minister for Financial Services and Superannuation's adviser, dated 25 May, 2012, under Freedom of Information. In part, this email discusses concerns lenders had raised about how the '20/4' cap will operate in practice. It states:

"*The 20/4 model is based on fees rather than interest, so that the comparison with a credit contract, in which interest can be charged on establishment fees is not relevant.*"

If the comparison is not relevant because interest cannot be charged (for example), how then is it suitable for the cost of SACCs to be expressed using APR?

Making a calculation under section 32B of the Code (as is proposed by the Panel) and having it apply to SACCs is simply ludicrous. Aside from the fact that section 32B refers to an 'annual cost rate' which is a different concept and use than an APR, the formulae runs afoul of the concepts in (a), (b) and (c) below.

APR does not provide any form of sensible metric for SACCs, because fundamentally:

(a) Annualising longer term products (multiple years) is vastly different to annualising products with terms of less than a year. The latter (where SACCs fit) requires a 'magnification' of figures - rather than an 'averaging' (which would apply to multiple year term products, as amortisation takes place). When SACCs are restricted to have terms from 16 days to 1 year, the magnification effect can range from misrepresentative to unconscionably negligent. By way of example:

A SACC for $500 for 1 month can have a maximum charge of 24% ($120). Expressed in the simplest annual form possible, this is 12 x 24% = 288%. The same loan for 1 year allows a maximum charge of 68% ($340), for a simple annual rate of 68%. Therefore, a loan with the same cost structure will (depending on its term):

(i) Cost less ($120), but have a higher rate (288%); or
(ii) Cost more ($340), but have a small rate (68%).

Using a formulated APR when many consumers readily understand dollars and cents will only create confusion. A rising rate coupled with a decreasing dollar cost is counter-intuitive.

Consumers cannot sensibly be expected to understand the actual cost of a SACC by reference to an APR when this simple exercise exposes a differential range of over 200% on one loan example;

(b) APR calculations, at least in the ways contemplated by the legislation, require a compounding factor in the formula. Traditional principal and interest products amounts allow unpaid amounts to be capitalised (i.e., the greater the outstanding balance, the greater the charges in dollar amounts), which makes a compounding factor relevant.

SACCs are specifically prohibited by the legislation from having their charges compounded. For instance, the monthly fees cannot be calculated so that the establishment fee is factored, and the monthly fee is completely independent of the balance owing on the loan. Forcing a calculation for a SACC using a formula which integrally uses a compounding factor can never give an accurate outcome; and

(c) SACCs have a restriction which is not present in other products and is not contemplated by the available APR formulae: they have a total cost of credit cap. Taking into account the types of fees and charges which may be taken into account for an APR-type calculation, the maximum charges allowable under a SACC in any one year period are 68% of the adjusted credit amount (20% establishment fee plus 12 times 4% monthly fees).

If the loan is not repaid by the borrower then the maximum total charge they can be required to pay (excluding enforcement expenses) is 100% of the amount received. Even then, however, for the SACC to approach this limit it must either have:

(i) Exceeded its maximum term; or

(ii) Gone into default.

Neither of these eventualities is required to be calculated into any currently accepted form of APR, since both circumstances are unascertainable at the time of entering into the contract.

Calculation issues aside, there are also legislative and enforcement difficulties in the implementing the recommendation.

Section 150 of the Code provides for disclosure of an 'annual percentage rate' in advertising. It states lenders do not need to quote an annual percentage rate in an advertisement unless stating the amount of any repayment. However, this does not appear to be a real requirement – at least, according to ASIC[5].

The Credit Act is not geared towards being able to 'slot in' a requirement around annual percentage rates with respect to SACCs. For example, section 27 of the Code provides definitions with respect to interest charges. The section:

(i) Defines the term with reference to the rate specified in the contract. This concept is predicated on the actual charging of interest, not an approximation of credit fees and charges; which is borne out of understanding that the rate needed to be stipulated in the credit contract (by subsection 17(4) of the Code) <u>does not</u> include the credit fees and charges payable under the contracts; and

(ii) References a 'daily percentage rate' by dividing the annual rate by 365.

Neither of these concepts are compatible with the way in which SACCs operate – there is no ability to charge an interest rate under the contract, and SACCs' fee structure is based on a calendar month so they are not easily divisible into a 'daily rate'.

[5] Despite the section requirement, ASIC Regulatory Guide 234 stating that websites are advertising, and having taken action previously in such circumstances (see ASIC media release 12-197MR), ASIC has recently refused to consider instances of lenders failing to quote APRs when advertising repayments. Ironically, ASIC uses this Review as a reason why they shouldn't take action.

Recommendation 23: Penalties
Encourage a rigorous approach to strict compliance by extending the application of the existing civil penalty regime to SACCs, and provide for automatic loss of the right to charges under the contract for specific obligations.

This recommendation, as stated in the Final Report and as applicable to SACCs, proposes:

- The loss of all allowable charges for a breach of a key or fundamental requirement; and
- Extending application of the civil penalty regime in Part 6 of the Code.

It is logically easier to look at this recommendation by considering what is already covered in the Code. Part 6 concerns penalties for defaults by credit providers. Section 111 lists key requirements of the Code which apply.

Table 5: Key Requirements under the Code

Subsection	Apply to SACCs	Description
17(3)	Yes	Disclosure of amount of credit
17(4)	No	Disclosure of annual percentage rate(s)
17(5)	No	Calculation of interest charges
17(6)	No	Disclosure of total amount of interest charges payable
17(8)(a), (b)	Yes	Disclosure of credit fees and charges. **Note:** Due to the particular nature of SACCs, this makes up for ss17(4) – (6), (11), 32(A) and 32AA not applying.
17(9)	Yes	Changes affecting credit fees and charges (changes to interest rates doesn't apply, obviously)
17(11)	No	Disclosure about default rates of interest.
17(15)(a), (b)	Yes	Disclosure about insurance financed by the contract.
17(15A)	No	Only applies to reverse mortgages.
23(1)	No	Prohibited credit fees and charges for contracts other than SACCs. However, see below.
32A(1)	No	Prohibition if annual cost rate exceeds 48% , stated to not apply to SACCs.
32AA(2)	No	Prohibition regarding annual cost rate for later changes to interest rates , stated to not apply to SACCs.

Table 5 shows the provisions which don't apply to SACCs do so because they apply to a specific product (eg reverse mortgages) or only relate to interest (which SACCs cannot charge).

The Part goes on to provide for the types of penalties that may be imposed in respect of SACCs. The Final Report expresses concerns that section 114 of the Code should be amended to allow consumers to recover amount under SACCs, because the section "*only allows a consumer to recover amounts based on the interest charges payable*"[6]. These concerns are extremely strange, considering subsection 114(1A).

Subsection 114(1A) specifically applies to SACCs and provides the Court may impose a penalty not exceeding the sum of the establishment fee and the total amount of monthly fees payable based on the term of the contract.

[6] At page 93.

Subsection 114(2) further allows the Court to impose a greater penalty if the debtor suffers a loss. Taken as a whole, the section allows the Court to strip the SACC lender of all monies in respect of the loan except the principal.

The potential 'loose end' is that subsection 23(1) of the Code is a key requirement – but it doesn't apply to SACCs. However, section 23A does apply to SACCs, and subsection 23A(2) provides that if a SACC seeks to impose a prohibited charge, then the provision in the SACC which imposes the liability is void to the extent it relates to the liability. To be clear, it is not 'written down to the extent where it is no longer prohibited'; the charge is completely removed, regardless of amount, as payment of that 'liability' is void. These provisions are mirrored in section 31B of the Code.

And, because SACCs can only impose credit fees and charges, the effect of sections 23A and 31B are actually more imposing that those contemplated in Part 6:

- Part 6 requires an application to Court and a determination to be made; whereas
- Section 23A automatically voids the liability without the need for judicial intervention.

This leaves the discussion of a breach by SACC providers of 'certain requirements'. The Final Report lists these as (as applicable to SACCs):

(a) Entering into a SACC where the consumer is required to make payments in excess of the protected earnings amount; and
(b) Entering into a SACC in breach of a prohibition on unsolicited sales.

Of those, only (a) is currently contemplated in the legislation because of the current requirement regarding the provision of SACCs to social security recipients. It must be noted this provision is in the Act, rather than the Code.

While it is admitted that there is no requirement for a SACC provider to forego the SACCs charges in event of a breach, the Act does provide that a breach of the requirement attracts a civil penalty of 2,000 penalty units.

As it currently stands, 2,000 penalty units equates to $360,000 for an individual or $1.8 million for a corporation. The absolute maximum amount earnable under the average $500 SACC, ever, is $500. Accepting that most SACC licensees are corporations, this means that provider would need to provide more than 3,600 SACCs to cover the maximum fine payable under this provision. Otherwise, the monetary penalty imposed is far greater than simply losing their charges. Put simply, the penalty for breaching the requirements already laid down in the legislation far exceeds what is being contemplated by the Panel.

While there is no referable penalty for unsolicited sales, we sincerely doubt the penalties which would be imposed (should it be legislated) would be any less than those contemplated above.

To summarise, the Final Report recommends extending the reach of penalties under the legislation but it already covers more than what is recommended in that:

(i) Breaching a key requirement renders the SACC provider liable to lose all fees and charges;
(ii) Imposing a prohibited charge under a SACC automatically loses the provider all relevant fees and charges;
(iii) Breaching the protected earnings amount requirements renders the SACC provider liable to fines of up to $1.8 million per breach – significantly more than losing their credit fees and charges; and
(iv) While there is no current penalty in respect of unsolicited sales, it is reasonable to assume that a similar penalty will be imposed should the issue be legislated.

Recommendation 24: Avoidance

The Government should address avoidance through entities using business models that are not regulated by the Credit Act, and address conduct by licensees adopting practices to avoid the restrictions on the maximum amount that can be charged under a SACC, or any of the conduct obligations that only apply to SACCs.

It is no wonder to us at all why businesses seek to avoid the draconian credit legislation.

As acknowledged by stakeholders on both 'sides', it is overly complicated. We have a regulator who is as arbitrary and subjective as the average schoolyard bully. Then, to top it off, we have a substandard pricing cap which does not allow a fair return for small business and has not ever been the subject of any level of credible scrutiny by government.

Why wouldn't someone look for any possible way to avoid it all? If SACC lenders treated consumers the way our industry has been treated by government, we would have been legislated out of existence years ago.

Rather than rehash the arguments in pages 63 to 65 of our initial submission to the Panel, we will simply point out SACC lenders do not avoid the Code in order to harm consumers. They don't do it because they're greedy and want to fleece consumers. They do it to survive, because the regulations are unfairly killing their livelihoods.

We want to make this point abundantly clear – avoidance is not the same as breaking the law. Seeking a lawful way to avoid a particular regulatory pitfall is an expression of a desire to comply with the law; in this case when it is all but impossible to survive the pitfall.

All of the arguments in favour of broad anti-avoidance provisions speak to a failure to accept that lenders have any genuine rights at all; and it is clear from the comments in the Final Report that the Panel considers lenders should be stripped of the right to be self-determining when it comes to how they operate. Instead, the Panel's contention appears that no matter what businesses do they should all be sucked in to the Code's confines.

To make it abundantly clear, because it is readily apparent there is a failure to properly consider the relevant factors:

(a) The Code is not all encompassing, it has definitive limits. Artificially attempting to stretch these limits beyond their legislated scope is blatantly reprehensible;

(b) Just because a consumer derives a monetary outcome from a transaction, it is not necessarily consumer credit. Such a sentiment is acknowledged time and again in superior court decisions:

(i) As the South Australian Supreme Court held in *Dyda Pty Ltd & Anor v Commissioner of State Taxation* when considering the determination of instruments and transactions,

"*There is no room for concepts of economic equivalence";*

(ii) As the Federal Court held in *Beconwood Securities Pty Ltd v Australia and New Zealand Banking Group Ltd*,

"*The character of a transaction is to be determined by reference to its legal nature, not to its economic effect*";

(iii) As Lord Devlin held in the Privy Council case of *Chow Yoong Hong v Choong Fah Rubber Manufactory*, "*There are many ways of raising cash besides borrowing... The task of the court in such cases is clear. It must first look at the matter of the transaction which the parties have agreed. If in form it is not a loan, it is not the point to say that its object was to raise money for one of them or that the parties could have produced the same result more conveniently by borrowing and lending money";* and

(iv) In the majority High Court decision of *Electricity Generation Corporation v Woodside Energy Ltd*,

"...this Court has reaffirmed the objective approach to be adopted in determining the rights and liabilities of parties to a contract"; and

(c) Despite the above, courts appear willing to ignore the rights of the business in favour of the consumer. In *Australian Securities and Investments Commission v Fast Access Finance* the Federal Court completely ignored the respondent's intentions in its manner of conduct. Instead, the judge only acknowledged the consumer's subjective intention in the transaction, ultimately (and unfairly, in our opinion) concluding that the model used "*added nothing to the transaction."*

Such sentiment fails to contemplate the respondent's argument that it had a legitimate reason for its conduct: it wanted to operate in a legitimate, legal manner without running afoul of a regulatory 'pitfall'. The court effectively held that it doesn't matter what the 'lender' does or why it does it - it is only the consumer's subjective intention that matters.

If the danger of such an approach is not readily apparent to the legislators, then they are not the appropriate people to be framing our laws.

Given the treatment of business, it's almost laughable to want to impose anti-avoidance provisions in the law - the regulator and the courts are already effectively obliterating any business practice which they consider doesn't fit with the 'whatever the consumer wants' mindset.

Finally, it is alarming to see the Panel recommend in the Final Report that powers should be given to minimise avoidance conduct by prohibiting such conduct "*before it occurs".* In that case, the totality of the industry might as consist of ASIC mandating one standardised loan which all lenders must provide.