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**By email: christian.mikula [at] treasury.gov.au; sue.bonnett [at] treasury.gov.au**

Christian Mikula and Sue Bonnett
The Treasury
Langton Crescent
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Dear Mr Mikula and Ms Bonnett

**Amendments to the Consumer Credit and Corporations Legislation Amendments Enhancements Bill 2011**

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on Amendments to the *Consumer Credit and Corporations Legislation Amendments Enhancements Bill 2011* (**the amended bill**).

In brief, this submission recommends:

- With regards to hardship variations
    - that Government consider providing detailed guidance to credit providers, perhaps through ASIC, to assist them to better assess and respond to requests for hardship variations.
    - that any notice provided under subsection 72(4) should inform a consumer about their rights to renegotiate the proposal if it is not suitable, and their right to seek to have the variation reconsidered through external dispute resolution processes.
    - that the note currently under subsection 72(3) be amended to be clear that credit providers must assess requests for hardship variations based on the information available to them, regardless of whether a debtor has provided information requested;

- that guidance be provided in regards to credit providers' obligations under section 128;

- that section 160E, which permits credit providers to seek repayment of loans using employer payment authorities, be removed from the bill;

- with regards to reverse mortgages, that amendments to paragraph 18A(3)(d) be removed so that credit providers may not begin enforcement proceedings because a borrower has failed to pay a cost unrelated to the reverse mortgage;

- the definition of Small Amount Credit Contract be amended to include only loans of below 12 months in length;

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- With regards to caps on costs in Schedule 4:
    - that the amendments to subsections 32A(2) and (3) be reversed and the original cap of 10 per cent establishment fee and 2 per cent monthly fee be reinstated;
    - that the wording of Subsection 31A(4) be clarified to ensure the Ministerial review can consider provisions outside of section 31A;
    - that text deleted from subsections 32B(3) and 39B(1) (which has the effect of moving important consumer protections from the Act to the regulations) be reversed.

Our comments are detailed more fully below.

**About Consumer Action**

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

We also operate MoneyHelp, a not-for-profit financial counselling service funded by the Victorian Government to provide free, confidential and independent financial advice to Victorians experiencing financial difficulty.

**Schedule 1: Enhancements**

Section 72: Changes on the grounds of hardship

*Broad remarks*

It is important that the legislative hardship process encourages credit providers to deal with the issue of long term hardship more effectively than they do currently. It is our view that credit providers tend to offer short-term relief, which may not be the most effective approach to dealing with a consumer's individual circumstances. For example, credit providers commonly offer a short-term payment moratorium as standard, rather than genuinely engaging with, and responding to, a borrower's specific situation. We note the findings from ASIC's 2009 report *Helping home borrowers in financial hardship*, as well as the views of Financial Counselling Australia in this regard.[1]

While we strongly support the proposed amendments insofar as they make seeking a hardship variation easier and less formal, we do not believe that the amendments will encourage credit providers to substantively approach requests for hardship variations any more flexibly or effectively. It may be useful to provide more detailed advice to lenders on this point.

[1] Financial Counselling Australia, Media release—Ombudsman's report highlights the need to tackle financial difficulty, available at: http://www.financialcounsellingaustralia.org.au/media%20releases%20documents/mr_11.12.11_ombudsman.pdf

**Recommendation:**

We recommend that Government consider providing detailed guidance to credit providers, perhaps through ASIC, to assist them to better assess and respond to requests for hardship variations.

*Notices under subsection 72(4)*

Subsection 72(4) requires credit providers to give debtors a notice, in the form prescribed by regulations, outlining their response to the hardship notice and reasons for refusing to vary a contract if a variation is refused. We welcome the requirement to provide reasons for refusal. However, notices both agreeing and refusing to agree to a variation should provide borrowers with more information to ensure that they are aware of their right to have the credit provider's decision reconsidered if the borrower believes it is unsatisfactory.

It is important that this kind of notice is given even when the credit provider decides to grant a variation (not only where they refuse to vary a contract). For example, a borrower may wish to request review of a decision to offer a short term arrangement where a long term solution was more appropriate.

**Recommendation:**

We recommend that any notice provided under subsection 72(4) should inform a consumer about their rights to renegotiate the proposal if it is not suitable, and their right to seek to have the variation reconsidered through external dispute resolution processes.

*Obligation of credit provider to make reasonable decision even if information is not provided*

The amended bill requires that, if a debtor provides a credit provider with notice that they may not be able to meet the requirements of their credit contract due to hardship:

- the credit provider may request that the debtor provide information relevant to the credit provider's decision of whether and how to change the credit contract in light of the hardship (subsection 72(2));
- the debtor must comply with the credit provider's request for information (subsection 72(3)); and
- the credit provider must make a decision and provide notice to the debtor in response to the hardship notice, even if the debtor did not provide the information requested (subsections 72(4) and (5)).

We welcome the obligation placed on credit providers by subsections 72(4) and (5) to make a decision even if information requested is not provided. However we consider this may give rise to an implication that credit providers can refuse a hardship request simply because a debtor does not comply with a request for information under subsection 72(2). As presently drafted, the bill allows a credit provider to refuse a hardship request for failure to provide information even if the credit provider already has sufficient information on hand to make the assessment. Indeed, the note under subsection 72(3) reads

> If the debtor does not comply with the requirement [at 72(2)], the credit provider may refuse to agree to change the credit contract.

In our experience, credit providers sometimes make unreasonable requests for information that should not be required to consider the application for hardship. For example, some credit providers have sought information such as doctor's certificates, tax returns and pay slips. Where a borrower has provided sufficient information about their income and expenditure, such other information should not be necessary. In some circumstances, consumers cannot reasonably get hold of this information, effectively denying their right to seek a hardship variation.

The amended bill should require credit providers to make a decision based on the information they have available to them. This would not disadvantage credit providers as they could still refuse to change the contract if they genuinely did not have necessary information to hand and the debtor refused to provide it.

**Recommendation:**

We recommend that the note currently under subsection 72(3) be deleted and replaced with:

> The credit provider must assess requests for hardship variations based on the information available to them and may not refuse to agree to change the credit contract solely because the debtor did not comply with the request at 72(2).

Section 128: Obligation to assess unsuitability

Section 128 prohibits credit providers from making unconditional representations to consumers that the consumer is:

- eligible to enter a credit contract with the credit provider; or
- eligible to have their credit limit increased.

We support this provision. However, we are concerned that through the addition of the word 'unconditional', credit providers may be able to avoid their obligations by making a representation prohibited by section 128 and then qualifying it afterwards, for example in fine print. Disclaimers and qualifications is a common technique used in advertising, and ASIC has already provided guidance about this issue. In its guidance on advertising of financial products and services, ASIC states:

> If warnings, disclaimers and qualifications are required, they should not be inconsistent with other content in the advertisement, including any headline claims. They should also have sufficient prominence to effectively convey key information to a reasonable member of the audience on first viewing of the advertisement. Information is less likely to be noticed and understood if it is in fine print, contained within a dense block of text, only shown on television or a computer screen for a brief period, or placed where there is distracting content shown simultaneously.[2]

[2] ASIC, *Regulatory Guide 234: Advertising Financial Products and Services* RG 234.46.

We support this approach and believe that the addition of the word 'unconditional' should not mean that lenders can rely on disclaimers or qualifications.

> **Recommendation:**
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> We recommend that guidance be provided, perhaps through the Explanatory Memorandum or a regulatory guide, clarify that a headline claim that would breach section 128 cannot be redeemed by later qualification.

Section 160E: Requirements for giving authorisation to employer

We do not support the proposal to create a process to facilitate employer payment authorities in section 160E. As we have argued to Treasury in the past, we believe that an outright ban on employer payment authorities should be the preferred policy response. Garnishing wages is an extraordinary debt recovery option which may have serious implications for debtors. It should only be permitted through a court supervised process.

We are particularly concerned that inclusion of a process to facilitate employer payment authorities will legitimise such authorities as a repayment tool, meaning that more lenders will seek to rely upon them. There is no valid reason why the law should encourage employer authorities as a repayment tool as opposed to other payment mechanisms or debt collection methods.

> **Recommendation:**
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> We recommend that section 160E be removed from the amended bill, and that the bill does not otherwise allow employer payment authorities in any form.

**Schedule 2: Reverse Mortgages**

Section 18A: Provisions that must not be included in credit contract for reverse mortgages

Section 18A prevents credit providers from beginning enforcement proceedings on a reverse mortgage for certain reasons, which are listed in subsection 18A(3). One of those reasons, at 18A(3)(d), has been amended from:

> …the debtor failing to pay a cost to a person other than the credit provider

to:

> …the debtor failing to pay a cost to a person other than the credit provider within 3 years after the payment became due.

We do not believe that failure to pay a cost a third party should ever be a reason for beginning enforcement proceedings on a reverse mortgage. This kind of conduct is outside of the scope of

the agreement between the consumer and the credit provider and we fail to see why failure to pay such a cost affects the credit provider's legitimate interests. The new words added to 18A(3)(d) should be removed.

**Recommendation:**

We recommend that the words "within 3 years after the payment became due" should be removed from paragraph 18A(3)(d).

**Schedule 3: Small Amount Credit Contracts**

Subsection 5(1): definition of Small Amount Credit Contract

Small Amount Credit Contracts are currently defined at proposed subsection 5(1) of the Enhancements bill as contracts which (among other things), are for an amount of $2000 or less for a term of 2 years or less. Contracts that are not defined as a Small Amount Credit Contract would have a cap on costs of 48 per cent per annum (with some exceptions).[3] These boundaries were originally developed with the understanding that the cap on costs for Small Amount Credit Contracts would be a 10 per cent establishment fee and a 2 per cent monthly fee (**the 10+2 cap**). If the cap is to be increased to allow a 20 per cent establishment fee and a four per cent monthly fee (**the 20+4 cap**) as is proposed, this will create two serious and unintended consequences.

The first is that the 20+4 cap creates a very rough transition between the Small Amount Credit Contract cap and the 48 per cent cap. As Table 1 demonstrates, a consumer borrowing $2000 over 24 months (regulated by the 20+4 cap) would pay up to $2320.00, while a consumer borrowing $2001.00 (regulated by the 48% cap) would pay up to $1,171.84. This is undesirable because of the increased potential to distort the market.

The NAB report *Do you really want to hurt me?* [4] (that has been heavily relied on by payday lenders to argue that a 48 per cent per annum cap is not viable for smaller loans) found that

> large fringe lenders, say with portfolios between $20 million and $100 million, are capable of delivering interest rates well below the 48% cap where the average loan size is around $1,000 [assuming a 12 month term].[5]

Where NAB found that 48 per cent cap was sufficient for large fringe lenders, the Enhancements Bill will actually permit lenders to charge the equivalent of an Annual Percentage Rate of over 100 per cent. It is difficult to see how this can be justified for loans of up to $2000 for periods over 12 months, even allowing some leeway for smaller, less efficient operators.

[3] Under proposed section 32A.
[4] NAB (2010) *Do You Really Want to Hurt Me? Exploring the Costs of Fringe Lending - A Report on the NAB Small Loans Pilot*, Accessed from http://www.nab.com.au/wps/wcm/connect/nab/nab/home/About_Us/7/4/3/6/
[5] NAB (2010), p 14.

**Table 1: Comparison of returns permissible for Small Amount Credit Contracts and contracts with 48 per cent cap**

| Amount | Loan term | Interest cost 48% p/a | Total charges (10+2) | Total charges (20+4) | Difference 20+4 and 48% | 20+4 cap: Amount of returns above 200% |
|---|---|---|---|---|---|---|
| $1,500 | 12 mths | $ 417.95 | $510.00 | $1,020.00 | $602.05 | 0 |
| $1,500 | 2 yrs | $816.12 | $870.00 | $1,740.00 | $923.88 | $240.00 |
| $2,000 | 12 mths | $557.26 | $680.00 | $1,360.00 | $802.74 | 0 |
| $2,000 | 2 yrs | $ 1,148.16 | $1,160.00 | $2,320.00 | $1,171.84 | $320.00 |

The second unintended consequence is that the proposed cap on costs allows lenders to make a return that is more than twice the amount loaned (prior to the application of any default fee or other contingency expense). For example, if lenders issue a 24 month loan of $2,000, their return will be $2,320. This is contrary to the intent expressed in proposed section 39B of the Enhancements Bill, which prohibits lenders recovering more than twice the amount loaned when the borrower is in default.

When the Enhancements Bill was introduced to Parliament, a press release from the (then) Assistant Treasurer Bill Shorten said that:

> The Gillard Government is determined to protect vulnerable consumers from the potential dangers of accessing credit with hidden risks or excessive interest rates.[6]

While the proposed cap on costs has changed, the intent of the Government to protect consumers from the dangers of these loans has not. However, under the current proposal, consumers will be exposed both to hidden risks (a $2000 loan costing over $1000 more than a $2001 loan) and excessive interest.

We recommend that the definition of Small Amount Credit Contract in proposed section 5(1) of the Enhancements Bill be changed to include only loans of below 12 months in length. These type of loans accord more with traditional 'payday loans' sought to be regulated by this bill. We are not aware of loans of between $1,000 and $2,000 for a period of greater than 12 months being offered by commercial lenders[7]—as such, this proposal should have limited impact on the market. Conversely, failure to amend the definition could see these loans being the cause of new problems, as lenders may be attracted to the higher returns they provide.

[6] 'New Consumer Credit Protections Introduced into Parliament', Press Release, The Hon Bill Shorten MP, 21 September 2011. Accessed from: http://assistant.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/133.htm&pageID=003&min=brs&Year=2011&DocType=0

[7] One exception we are aware of in NSW is lenders offering loans in this range for terms ostensibly longer than 12 months. However, this appears to be an artifice avoid the current NSW rate cap—we are not aware of a single borrower who has not "opted" to pay the loan out over a shorter period and incur a deferred establishment fee in the process. In practice these loans are usually paid out over around seven months.

In the interests of being abundantly clear, we firmly believe that a cap on costs of Small Amount Credit Contracts should be designed to make the shortest term loans unviable and encourage the payday lending industry to offer longer term contracts which will cause less financial hardship for borrowers. However, to move to the situation described in the table above would be a substantial over-correction and probably cause more problems than it solves.

**Recommendation:**

We recommend that the definition of Small Amount Credit Contract be amended to include only loans of below 12 months in length.

**Schedule 4: Caps on Costs**

Section 31A: Restrictions on fees and charges for small amount credit contracts

Section 31A determines the fees and charges that can be imposed under a small amount credit contract. We oppose the amendment to subsections 31A (2) and (3) to increase the cap on costs for small amount credit contracts.

The benefit of the cap originally proposed (a 10 per cent establishment fee plus a two per cent monthly fee) was that it would have made the shortest term loans (which are the most harmful loans) unviable and so force the market to shift to longer term, more affordable loans. The amended cap (20 per cent establishment fee and 4 per cent monthly fee) will largely fail to achieve this result and so will be an ineffective consumer protection. In effect, this amendment will 'legalise' payday lending.

**Recommendation:**

We recommend that the amendments to subsections 32A(2) and (3) be reversed and the original cap of 10 per cent establishment fee and 2 per cent monthly fee be reinstated.

Subsection 31A(4): Ministerial Review of section 31A

Subsection 31A(4) requires the Minister to cause an independent review of the operation of section 31A to take place two years after the commencement of that section. We support a review of the Small Amount Credit Contract regulatory regime, but it must be broader than only section 31A. For example, the thresholds that define Small Amount Credit Contracts in Schedule 3 would also need to be considered to ensure any review was properly informed. We recognise that it may have been the intent of 31A(4) that sections other than 31A could be considered in the review, but we believe this is not clear on a plain reading.

**Recommendation:**

We recommend that the wording of Subsection 31A(4) be clarified to ensure the review can consider provisions outside of section 31A.

Subsection 32B(3): Calculation of Credit Cost Amount

We are concerned that subsection 32B(3) has been deleted from the amended bill.

Subsection 32B(3) requires that any:

- credit fees and charges; or
- amounts paid to the credit provider or another person for introduction to the credit provider, or any other service;

be included in the calculation of the cost of credit for the purposes of section 32A, which prohibits certain credit contracts from charging an annual cost rate over 48 per cent.

Experience from other jurisdictions which have imposed a cost cap on credit contracts has shown that some lenders will try to evade the cap by imposing fees ostensibly for brokerage or for the provision of other goods and services. The provision at subsection 32B(3) helps address that method of avoidance and it is important that it is retained.

We are aware that this provision will be replaced by regulations. However it is not clear what the content of those regulations will be, and there is a risk that they may offer a lower standard of consumer protection. We are also concerned that, even if the regulations provide the same level of protection as currently contained at subsection 32B(3), those protections will be more easily weakened by governments in future than if they were retained in the Act.

**Recommendation:**

We recommend that the amendment to subsection 32B(3) be reversed.

If the amendment to subsection 32B(3) goes ahead, we strongly recommend that regulations must provide at least the same level of consumer protection provided by the subsection.

Subsection 39B(1): Limit on amount that may be recovered if there is default under a small amount credit contract

We are also concerned that a consumer protection at subsection 39B(1) has been removed from the amended bill. Subsection 39B(1) prevents lenders of small amount credit contracts from recovering an amount more than twice the amount loaned if a borrower defaults. This is an extremely important consumer protection which prevents excessive default fees being charged which can exacerbate a borrower's financial hardship and lead to spirals of debt. This protection should be contained in the Act rather than the regulations.

**Recommendation:**

We strongly recommend that the amendment to subsection 39B(1) be reversed and this protection be contained in the Act rather than the regulations.

If the amendment to 39B(1) goes ahead, we recommend that the regulations provide the same level of consumer protection that 39B(1) currently does.

Please contact David Leermakers on 03 9670 5088 or at david@consumeraction.org.au if you have any questions about this submission.

Yours sincerely
**CONSUMER ACTION LAW CENTRE**

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