26 February 2013

**By email: melanie spong[at]asic.gov.au**

Melanie Spong
Senior Specialist
Deposit Takers, Credit and Insurers
Australian Securities and Investments Commission
GPO Box 9827
Sydney NSW 2001

Dear Ms Spong

**Consultation Paper 198: Review of the Effectiveness of an Online Database for Small Amount Lenders**

The Consumer Action Law Centre (**Consumer Action**), Consumer Credit Legal Service Western Australia and Financial Counselling Australia welcomes the opportunity to comment on ASIC Consultation Paper 198: Review of the Effectiveness of an Online Database for Small Amount Lenders (**the consultation paper**).

Briefly, our submission:

- supports the development of a small amount credit contract loans database (or a similar system) because it will be very difficult to ensure compliance with the new responsible lending presumptions to be introduced on March 1 2013;
- acknowledges that colleagues in other consumer and privacy advocacy organisations hold privacy concerns about the database proposal but considers that these concerns can be addressed by careful design of the database;
- recommends that Government continue to investigate the details of how an online database would work (including how personal information of consumers would be protected) and also consider the costs and benefits of alternatives including systems based in the existing credit reporting system; and
- responds to the questions in the consultation paper.

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 offers free legal advice, pursues consumer litigation and provides financial counselling to vulnerable and disadvantaged consumers across Victoria. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law

**Consumer Action Law Centre**
Level 7, 459 Little Collins Street Telephone 03 9670 5088 info@consumeraction.org.au
Melbourne Victoria 3000 Facsimile 03 9629 6898 www.consumeraction.org.au

ABN 37 120 056 484 ACN 120 056 484

reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

**Broad position on a database**

The need for a database or similar system

The *Consumer Credit Legislation Amendment (Enhancements) Act 2012* introduces new responsible lending presumptions regarding small amount credit contracts which will commence on 1 March 2013. These new provisions require that lenders and providers of credit assistance presume a small amount credit contract to be unsuitable for a consumer if:

- the consumer is already in default on another small amount credit contract (**'the default presumption'**); or
- the consumer has been a debtor under two or more small amount credit contracts in the previous 90 days (**'the 90 day presumption'**).[1]

While we support the intent behind these presumptions, it will often be impossible for lenders to know whether one of them is triggered. Save for relying on consumer disclosure, there is presently no simple and reliable way for lenders to obtain necessary information such as whether a borrower has had previous loans before a loan is advanced, or whether an existing loan is in default. Given the precarious financial situation of many borrowers and the potentially urgent need for funds we think it unrealistic to expect that consumer disclosure will suffice. Indeed we could readily see that the greater the desperation for the funds the less likely complete disclosure may be.

While the Enhancements Bill will introduce an obligation on providers of credit and credit assistance to review the previous three months' bank statements,[2] such a review might not necessarily help a lender obtain the relevant information:

- borrowers may use multiple bank accounts;
- repayments made through wage deduction authorities will not be identified on bank statements;[3]
- borrowers may have used their partner's bank account to pay off previous loans;
- borrowers may obtain multiple loans in a short period of time such that repayments are not yet disclosed on bank statements accessible to the lender;
- bank statements can be irregular (and borrower may have to pay a fee to obtain it from their bank teller).

If there is no easy way for a lender to assess whether the presumptions apply, it will be extremely difficult for ASIC to enforce those presumptions. We support the development of a small amount credit contract loans database (or a similar system) because without it the new presumptions will be of limited use.

[1] The presumptions will be at subsections 131(3A), 133(3A) 118(3A) and 123(3A) of the National Credit Code.
[2] At subsections 117(1A) and 130(1A) of the National Credit Code.
[3] The Enhancements Bill will introduce a section 160E to the National Credit Code which will permit credit providers or lessors to give an authority (signed by the debtor) to the debtor's employer which requests that they pay loan repayments directly from the debtor's wage.

Concerns with a database

We acknowledge that colleagues in other consumer and privacy advocacy organisations do not support the idea of database largely because of concerns about the use of personal information. We refer you to the submission from the Australian Privacy Foundation which sets out this view in more detail. Colleagues have also questioned whether a new quasi-credit reporting process should be established instead of, for example, requiring lenders to use the existing credit reporting system which comes with existing consumer protection and privacy protections.

The privacy concerns held by our colleagues are legitimate. However, we consider that the harm caused to vulnerable consumers by irresponsible high cost short term lending must also be considered.

There is an urgent need to respond to the systemic failure of the payday lending industry to meet its responsible lending obligations. ASIC's 2010 review of responsible lending conduct by payday lenders[4] confirmed long held views of consumer advocates that there was significant non-compliance with responsible lending requirements in this industry. Presumptions such as those to be introduced by the Enhancements Act will go some way to limiting repeat borrowing and rollovers and so force business to change their lending behaviour. However, these presumptions will only work if they can be enforced.

Given our view that the presumptions must be enforceable to effect any behavioural change, and that many of the privacy concerns can be ameliorated by careful design, on balance we support a well designed database which places strict limits on how information is collected, stored and disclosed, including the parties that may access the information and on what basis. It is also critical that the operation of the database be closely controlled by ASIC (or another arm of Government) rather than being run by the payday lending industry. We also have sympathy for the view that an approach which uses the existing credit reporting system may be as successful and less risky for consumers than a stand-alone database.

Our Recommendation

It is our view that Government should continue to investigate the details of how an online database would work, including how personal information of consumers would be protected. However, Government should also consider the costs and benefits of alternatives options, including:

- requiring that small amount credit contract providers participate in the existing credit reporting system; and
- creating a database which is a separate tier of the existing credit reporting system. Under this structure, small amount credit contract providers would still be required to report the contracts they enter, but only limited data would be submitted to the credit reporting system (see our response to question B2, below) and lenders would only have access to the minimum necessary information to disclose if a presumption is triggered.

The rest of the submission assumes that an online database of the kind described by the consultation paper goes ahead.

[4] Discussed briefly at paragraphs 7-9 of the consultation paper

**ASIC's ability to enforce the law without the database**

The Minister's request for ASIC review requested information not only on the effectiveness of an online database but

> The existence of any limitations in the provisions applying to small amount credit contracts in the Enhancements Act which would prevent ASIC from taking court action against small amount lenders, or severely restrict [ASIC's] capacity to do so.[5]

As discussed above, we do not believe the requirement for small amount credit contract providers to consider 90 days of bank statements will necessarily assist compliance or enforcement of responsible lending provisions.

But in addition to this, there are a number of reasons why ASIC will have more difficulty enforcing responsible lending laws against small amount credit contract providers than mainstream lenders:

- It is well established that the majority of small amount credit contracts are used to pay for everyday, recurrent living expenses (rather than one-off purchases or emergencies)[6]. A consumer seeking a third loan in three months for everyday living expenses (that is, someone who should trigger the 90 day presumption) is likely to be somewhere between highly motivated and desperate to obtain the loan. This increases the likelihood they will say what they need to get the loan (truthful or not) and decreases the likelihood they will complain;
- Repeat borrowing is profitable so lenders are likely to be motivated to engage in a range of behaviours from 'tick-a-box' compliance to avoidance;
- Information about the relevant misconduct will need to reach the regulator before they can take action to enforce the law, and will need to do so in a timely way;
- The regulator will need enough evidence to establish that behaviour is more than 'one-off' or isolated or attributable to a 'rogue' staff member. This will require similar evidence from multiple consumers;
- Where consumers' evidence can be attacked (for example, because they have been less than truthful in their loan application), additional and more substantial evidence will be needed;
- At least part of a case is likely to rely on evidence of what was said at the time of lending. This will often involve two conflicting versions of events—the consumer's and the trader's. This makes litigation riskier; and
- Consumers' motivation and ability to participate in an enforcement action is likely to be impacted by some or all of:
    - shame
    - embarrassment
    - guilt
    - vulnerability
    - the stability of personal circumstances
    - the potential for adverse allegations to be made against them (for example, fraud or dishonesty)

[5] See page five of the consultation paper.

[6] See for example Banks, Marston, Karger and Russell (2012) *Caught Short: Exploring the role of small, short-term loans in the lives of Australians: Final Report*, p vii; Gillam and Consumer Action Law Centre (2010) *Payday Loans: Helping Hand or Quicksand?* , p 6.

- the potential for adverse findings to be made about them
- lack of time
- the lengthy period such actions take from investigation to hearing (commonly several years)
- the fact that consumer redress may be a secondary consideration in the action - or in some cases not a feature at all
- other priorities (e.g. work, family etc).

Some or all of these barriers may apply to each enforcement action a regulator wishes to take that involves consumer evidence. This will make it difficult for ASIC to enforce the responsible lending laws even in individual circumstances, much less to effect systemic change across an industry.

**Response to questions**

***Question B1:*** *Should it be mandatory for credit licensees:*

a. *to register all small amount loans in a database; and*
b. *to make an inquiry from the database to determine whether a consumer has two or more small amount loans in the preceding 90 days or whether a consumer has a current small amount loan that is in default before entering into a new small amount loan?*

Yes, assuming a database can be designed to minimise risks of misuse or disclosure of personal information. Penalties should apply where businesses fail to register small amount loans or make an inquiry to the register as required.

In our opinion, it is more important for the database to be able to provide information on whether a consumer has had two or more small amount loans in the preceding 90 days than it is for the database to be able to report defaults. We explain this point in our response to question B2, below.

***Question B1Q1:*** *Would such a requirement be an effective means of enabling small amount lenders to determine whether consumers trigger the presumption of unsuitability?*

Yes. As we have argued above, there is currently no simple and reliable way for small amount credit contract providers to determine whether consumers will trigger the presumption of unsuitability. A database would be an simple and effective means of considering the presumption because it will be a far more reliable record of loans than bank statements and if designed well it could give a response immediately on whether a presumption is triggered.

***Question B1Q2:*** *What would be the likely cost to credit licensees or to consumers of such a requirement? We are interested in the likely cost of entering data into the database as well as the cost of making a database inquiry.*

The experience of databases in the US (cited in the consultation paper) suggests that these systems can cost as little as $1 for each entry made on the database, which can then be passed onto the borrower. If a similar cost applied to an Australian system and lenders were required to record only minimal information (as we recommend below) the burden to lenders would be very small.

However, we accept that the Australian and US regulatory environments are different and that further work will have to be done to ensure that a database could be sustainable and meet Privacy Act requirements for $1 per entry.

***Question B1Q3:*** *Are there potential flow-on effects or consequences from making such a requirement? For example, would credit licensees be less likely to subscribe to credit reporting agencies because this is not mandatory and would incur an additional cost?*

A database would not make licensees less likely to subscribe to credit reporting agencies if the database only provided very limited information—namely whether a presumption was or was not triggered.

When licensees access credit reports from credit reporting agencies they are provided with information about

- whether a credit provider has sought a credit report regarding an individual and the amount of credit sought in the application
- an individual's current credit providers
- any credit defaults; and
- a credit provider's opinion that the individual has committed a serious credit infringement.

After the introduction of comprehensive credit reporting (expected to commence in 2014) far more detailed information will be available, including dates credit accounts were opened and closed, credit limits of accounts and repayment history of the individual.

This amount of information could never be provided by the kind of database the consultation paper envisages. Licensees who rely on reports from credit reporting agencies will still need to access them if a database is established.

***Question B1Q4:*** *Does the fact that the Australian responsible lending obligations involve a principles-based approach, plus specific rebuttable presumptions for short-term loans, mean that a database would be less useful than in overseas jurisdictions where the legal requirements are more definitive?*

No. Although we would prefer the Enhancements Act had introduced hard limits on the number of small amount credit contracts individuals can enter (that is, that it had prohibited more than two loans in 90 days rather than only presuming the third to be unsuitable) the presumptions to be introduced are fairly definitive.

For example, we think there will only be very rare occasions when a third loan in 90 days will be suitable for a borrower. If a borrower needs to take out an average of one small amount credit contract per month for three months then it should be clear that the previous loans had not met the needs of the borrower or were not affordable. We could only imagine the presumption being rebutted where the borrower had moved to a higher paying job or had come into a windfall.

***Question B1Q5:*** *Would such a requirement lead to avoidance, such as structuring loans that fall outside the definition of a small amount credit contract?*
History suggests that providers of small amount credit contracts will try to avoid the credit law[7]. However the database itself will not encourage avoidance if well designed. To our knowledge, lenders have tried to avoid credit law in the past to allow them to make more money on their loans than the law allows. The database will not create any incentive to avoid the law if it only costs $1 (or a similar amount) per entry and that amount can be passed onto consumers.

On the contrary, a database (or something like it) is in our view necessary to allow compliance with the presumptions in the first place. We also note that the Enhancements Act includes a number of specific features to address known avoidance strategies and that the *National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012* proposes a general anti-avoidance provision.

***Question B2:*** *If a database of small amount loans is in place in Australia, what information should be recorded in it and made available to a small amount lender on inquiry?*
*Possible options for information to be included on the database are:*

a. *the identity of the borrower;*
b. *the loan amount;*
c. *the loan start date;*
d. *the loan contracted completion date;*
e. *the actual loan completion date; and*
f. *whether an existing small amount loan is in default.*

The database must at least record items a, b, c and d to allow compliance and enforcement of the 90 day presumption. Items e and f are needed to enforce the default presumption, however we would still support a database that did not record these two items.

A response to this question depends on what we want the database (and regulation of payday lending more generally) to achieve. We believe the serious problem with payday lending is that this business model encourages problematic repeat borrowing which leads borrowers into more and more debt. The benefit of the 90 day presumption is that it addresses this problem by applying a brake on repeat lending which prevents further debt accruing. For this reason, we believe the database should be designed to enable compliance with the 90 day presumption as a priority.

The default presumption is also important, however it is less well targeted to the problems in the payday lending business model. The standard practice in the payday lending industry is that loans are typically repaid through direct debit arrangements which are designed to take repayments from a borrower's bank account soon after their income is deposited. These arrangements mean few borrowers will default on their loan repayments even if the loan is unsustainable—where a borrower cannot afford to repay the loan as well as meet essential expenses (like rent, utilities, etc) the direct debit arrangement ensures it is the essential expenses that remain unpaid instead of the credit contract. This is the reason why the payday lending industry can remain profitable despite issuing loans that people cannot repay. It is also

[7] See, for example the discussion of lender avoidance after the introduction of caps in NSW and Queensland in Gillam (2010), chapter 5.

the reason why taking out one payday loan often leads to a borrower starting a cycle of repeat borrowing.

Including items e and f to promote compliance with the default presumption may also create incentives for avoidance. Items a, b, c and d would all be entered into the database at the start of a loan and as far as we can see there would be little incentive to enter incorrect information. However items e and f would require a later entry (creating more burden for lenders) and it may be in the interests of a lender to not report those details. For example, if a borrower has a current loan with a particular lender but has not been able to pay it off as scheduled and is in default, they may return to the original lender and seek a rollover. That lender must presume that the rollover is unsuitable under the default presumption. However, there would be an incentive to allow the database to stay silent on the default (making it look as though the loan was paid off on time) and offer the new loan under the table.

In summary, we remain of the view that it will be difficult to ensure compliance with the default presumption unless the database records items e and f. However, we would support a database that only contained items a, b, c and d because:

- the database would still assist compliance with the 90 day presumption, which is the most important issue; and
- the benefits of including items e and f on the database may be negated by creating a incentives for not listing the information required.

***Question B2Q1:*** *Are there any practical difficulties in obtaining the relevant information to be included in the database?*

Not if lenders are only required to record the identity of the borrower, loan amount and loan start and contract end date. All of these pieces of information are available when the lender enters the loan.

***Question B2Q2:*** *Does entering the actual completion date of a small amount loan raise practical difficulties?*

AND

***Question B2Q3*** *Would it be problematic for lenders to include information on the default of small amount loans in the database, noting that this would require a credit licensee to provide information to the database during the course of the loan (rather than only at the commencement and completion of the loan).*

Possibly. We have discussed this in our response to question B2.

***Question B2Q4*** *What information should be provided to the lender who makes an inquiry of the database? For example, should the database provide the inquiring lender with a response as to whether the consumer triggers the presumption of unsuitability and a brief reason, or should more details of the relevant small amount loans held in the database be released?*

The database should disclose the least amount of information necessary to credit providers. When a credit provider makes an inquiry, the database should only say:

- that no presumption is triggered based on the information in the database;

- that the default presumption is triggered; or
- that the 90 day presumption is triggered.

However, the regulator should be able to access a wider range of information to allow them to monitor compliance and enforce the law. Access to information by the regulator raises separate privacy issues but as before we believe they can be resolved through careful design.

***Question B2Q5:*** *Should a consumer have access to the database and, if so, what information should a consumer be able to obtain?*

Yes. In our view there is no question that consumers should be able to access the information about them listed on the database just as they can do with information on their credit report. There should also be a simple process for requesting correction and removal of incorrect or incomplete information. This could be based on the process set out in section 20U of the *Privacy Amendment (Enhancing Privacy Protection) Bill 2012*

***Question B2Q6:*** *How can the accuracy of the database be assured?*

AND

***Question B2Q7:*** *How should consumer concerns about the accuracy of the database be addressed? For example, should there be internal and external dispute resolution requirements?*

The accuracy of the database could be maximised by:

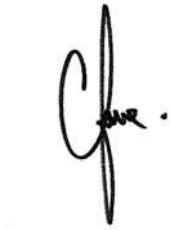
- making penalties available for failing to update the database—to create disincentives to avoidance;
- free access for consumers to their record and a simple correction process;
- a system of regular ASIC audits
- Access IDR and EDR—details of how this would work need to be considered during development and based on what exists currently in consumer credit and credit reporting.

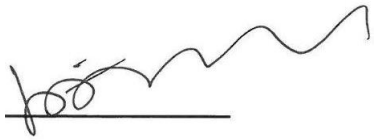
***Question B2Q8:*** *Are there any concerns relating to the Privacy Act 1988 because of information held in the database*

As explained above, we acknowledge the views of other consumer and privacy advocates who have concerns that a database may be developed without the privacy protections that exist in the existing credit reporting system. These concerns deserve further discussion, but as we have argued above, we believe they can be overcome through careful design.

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

Yours sincerely





| | | |
|---|---|---|
| Catriona Lowe<br>Co-CEO<br>Consumer Action Law Centre | Faith Cheok<br>Principal Solicitor<br>Consumer Credit Legal Service (WA) | Fiona Guthrie<br>Executive Director<br>Financial Counselling Australia |