consumer action law centre

Consumer Credit Legal Centre NSW

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By email: consumercredit@treasury.gov.au

Manager
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The Treasury
Langton Crescent
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Dear Sir or Madam

Exposure draft consumer credit regulations

The Consumer Action Law Centre (**Consumer Action**) and the Consumer Credit Legal Centre NSW (**CCLC NSW**) welcomes the opportunity to comment on the exposure draft consumer credit regulations released for comment on 7 February 2014.

In summary, we are supportive of the proposed regulations, and the efforts by the Federal Government to close loopholes in credit legislation that payday lenders exploit to avoid consumer protections, including licensing requirements and caps on costs that payday lenders are permitted to charge. However, we submit that there are various refinements to the regulations needed, to ensure that the lenders are not able to circumvent consumer protections—these refinements are detailed in this submission.

More broadly, we submit that the Government should consider including a general anti-avoidance provision in the national credit laws. There has been a long history of avoidance strategies employed by fringe lenders across the credit industry. The very fact that avoidance strategies have been exploited by lenders in the payday lending sector, so soon after much more comprehensive regulation of that sector, suggests that the regulatory regime needs a more flexible anti-avoidance provision to discourage avoidance and enable the regulator to take action before widespread consumer detriment occurs.

Proposed regulation 4D: meaning of small amount credit contract—credit limit

Consumer Action and CCLC NSW support the additional regulation to clarify the $2,000 credit limit for small amount credit contracts. So as to allow for a smooth interaction with medium credit contracts (with credit limits between $2,001 and $5,000), it is necessary to clarify whether fees and charges are to be included within the credit limit or not. We support the intent of the legislation that the small amount lending cap applies to contracts where the consumer receives a maximum amount of $2,000, with fees and charges allowed to be additional.

The drafting of this regulation, however, is complex. It would be perhaps simpler for the regulation to state that the credit limit of $2,000 in the definition of small amount credit contract in section 5(1) of the National Consumer Credit Protection Act (the **Act**) means that the consumer receives no more than $2,000, not including fees and charges. We would also recommend that the regulation include a note referring to section 31A of the National Credit Code (the **Code**) which restricts the fees and charges that can apply to a small amount credit contract.

We note that a similar problem may occur in relation to the definition of credit limit in relation to medium amount credit contracts in section 204(1) of the Code. We encourage Treasury to consider whether a similar clarification provision is required.

Proposed regulation 50A: Small amount credit contract—fees and charges

Consumer Action and CCLC NSW support proposed regulation 50B. This provision intends to capture avoidance of the Code by lenders that structure contracts as low-cost short-term credit contracts exempted by the Code pursuant to section 6(1). We are aware of lenders that have exploited this exemption, by imposing additional charges relating to the use of stored-value cards, fees for membership, or other fees.

In our view, many of the additional fees imposed by such lenders are already captured by section 6(2) which expands the definition of 'fees and charges imposed or provided for under the contract' for the purposes of section 6(1) as follows

(2) For the purposes of paragraph (1)(b), credit fees and charges imposed or provided for under the contract are taken to include the following, whether or not payable under the contract:

> *(a) a fee or charge payable by the debtor to any person for an introduction to the credit provider;*
> *(b) a fee or charge payable by the debtor to any person for any service if the person has been introduced to the debtor by the credit provider;*
> *(c) a fee or charge payable by the debtor to the credit provider for any service related to the provision of credit, other than a service mentioned in paragraph (b).*

However, to our knowledge, there has been no enforcement action relating to businesses that claim their contracts are subject to this exemption, despite the existence of section 6(2).

Further, some entities have carefully structured their arrangements to attempt to avoid these sections:

Example

One entity claims to be a broker/service provider which charges consumers for sourcing loans, and guaranteeing a fast deposit directly to the consumer's account. The entity claims to fall outside the ambit of the Act and the Code as a result of sub-sections 6(1) and (2). Specifically:

a) They do not charge for an introduction to the credit provider (any potential customer is welcome to request the lenders contacts details free of charge, deal directly with them and receive a cheque in the mail instead of instant cash in their account);
b) They have not been introduced to the borrower by the credit provider—in fact it's the other way around; and
c) Their fees and charges are not payable to the credit provider at all, but directly to the

broker/service provider.

The fees in fact charged would clearly exceed the section 6(1) threshold and neither the lender nor the broker/service provider's business models would be viable without the other. The entity also vehemently rejects that the fees would be caught by the phrase "*imposed or provided for under the contract"* and quotes case law to support this.

In a recent Determination by the Credit Ombudsman,[1] CCLC NSW successfully argued that the fees charged by these entities (the lender and the broker/service provider) were caught by the Code but this was a hotly contested matter. We are also concerned that some aspects of the decision implied that the arrangement may have successfully avoided the application of sub-sections 6(1) and (2) had the contractual arrangements and correspondence been more carefully drafted.[2] It is clearly preferable that the situation be put beyond doubt by the combined effect of proposed regulation 50A and 79AE (below).

For this reason, we support the regulation to clarify the types of fees that are prohibited in relation to low-cost short-term credit contracts pursuant to section 6(1) as follows:

We are concerned, however, that by regulation 50A listing three types of fees which are covered, the regulation invites further avoidance strategies where fees may be imposed that do not neatly fit within those listed. For this reason, we submit the Code can be enhanced by a more general anti-avoidance provision (see below).

We note that there is an error in the drafting of regulation 50A(a) which refers to 'section 204 of the Act', when it should read 'section 204 of the Code'.

Proposed regulation 51: Exempt credit—maximum account charges

Consumer Action and CCLC NSW support proposed regulation 51. We understand the intent to address exploitation of the low-cost continuing credit contract exemption is section 6(5) of the Code. The regulation would prevent small amount credit providers from charging the maximum fee for such contracts where they are arranging for a consumer to enter into a new continuing credit contract each time the consumer requires a further advance.

We note, however, that item 2 of the table in regulation 51 only applies if 'the debtor is already a party to a continuing credit contract'. There is a risk that a credit provider would terminate (or allow a consumer to terminate) a continuing credit contract, then immediately create a new

[1] Credit Ombudsman Service, Determination 021, 13 January 2014, available at: http://www.cosl.com.au/cosl/assets/File/Determination%20-%2013%20January%202014(1).pdf.

[2] Having regard to the preferred interpretation of the relevant section of the NCC, we consider the FSP's position (i.e. that these fees and charges were not imposed or provided for under the credit contract) untenable in view of the following facts: (a) the first loan contract, which names the consumer, CAP and CP as parties, states that: "This is the entire agreement."; (b) there is no evidence of separate contracts being entered into as between the consumer and CAP, or the consumer and CP; (c) the first loan contract refers to the services offered by both FSPs under the contract collectively; (d) under the first loan contract, the consumer was obliged to repay the principal amount and all fees and charges by direct debit, without specifying which amounts were supposedly payable to each FSP separately; and (e) the following statement contained in the first loan contract (as well as CAP's website) indicates that CAP provided credit assistance to the consumer and introduced the consumer to CP: *we are a business called [CAP] and are **facilitators** for the company [CP] I we forward your details to [CP] for processing ...*

continuing credit contract, entitling it to charge $200 in accordance with item 1 of the table. Treasury should consider the risk of this type of behavior, and consider amending the regulation to address this.

Consumer Action and CCLC NSW submit that there remains the opportunity for Code avoidance due to the definition of 'continuing credit contract' generally. Section 204 of the Code provides that a continuing credit contract is one under which multiple advances of credit are contemplated, and the amount of the available credit ordinarily increases as the amount of credit is reduced. We are aware of some businesses that arrange contracts as continuing credit contracts despite additional credit not being contemplated by the parties. We submit these types of contracts require close analysis. We are particularly concerned by businesses that arrange continuing credit contracts where the credit is tied to the purchase of a particular good or service (and additional purchases are not contemplated). At the very least, in this circumstance, there should be a presumption that such credit is not a continuing credit contract.

Proposed regulation 79AE: Small amount credit contracts (fees and charges)—prescribed persons

Consumer Action and CCLC NSW strongly support proposed regulation 79AE. This regulation responds to a concern we identified when the initial regulations were enacted.

Section 31B of the Code is aimed at limiting avoidance of the small amount lending cost cap through disbursement of costs across parties. It states that a credit provider or prescribed person must not require or accept payment of a fee or charge in relation to a small amount credit contract, other than the allowed fees. The explanatory memorandum explained that this provision operates as an anti-avoidance mechanism:

This addresses both historic and current concerns about credit providers in the short term lending market using sophisticated legal techniques to avoid existing State and Territory caps on costs. Avoidance mechanisms include a 'broker' model, using third parties to obtain additional fees and charges by way of brokerage, the requirement to purchase a product at an inflated price in order to obtain a loan, and the requirement to obtain, from a third party, verification that the application is creditworthy. Allowing for the prohibition to extend to third parties is necessary to prevent such avoidance techniques migrating to small amount credit contracts.

Despite this intention, the definition of prescribed person for the purposes for this provision was limited to 'a person who has been introduced to a debtor by a credit provider to provide a service in relation to a small amount credit contract (whether or not the person is associated with the credit provider' [regulation 79AB]. This regulation suggests that for a person to be a prescribed person, the credit provider must be the introducer. Therefore, a broker who introduces a debtor to a credit provider would not be regarded as a prescribed person. Similarly, where a consumer credit insurer is introduced to a debtor by a broker (and not the credit provider), the insurer will not be a prescribed person. Given this, the initial regulation inhibited section 31B operating to stop these parties from accepting or requiring a fee or charge in relation to a small amount credit contract.

Proposed regulation 79AE extends the prescribed persons for the purposes of this provision to include:

- persons who introduce the debtor to a credit provider (whether or not the person is associated with the credit provider); and
- persons who have been introduced to a debtor by a credit provider to provide a service in relation to a small amount credit contract (whether or not the person is associated with the credit provider).

This would capture brokers (first dot point) and other service providers (second dot point, e.g. consumer credit insurers), but only where the service provider is introduced by the credit provider. Consumer Action and CCLC NSW submit that the definition of prescribed persons should be expanded to persons introduced to a debtor to provide a service in relation to a small amount credit contract, whether or not the introduction is ‘by the credit provider’. For example, the person could be introduced by the broker—we are aware of at least one payday loan broker that introduced a consumer credit insurer. The regulation as currently drafted does not appear to capture this practice.

A general anti-avoidance provision

In addition to the regulations proposed, the Government should consider including a general anti-avoidance provision in the national credit laws.

A general anti-avoidance provision would be designed to allow ASIC to take enforcement action if it detected a scheme by a trader which was designed to avoid the operation of the Credit Code. The draft National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012 which was distributed for comment in early 2013 included (among other things) such a provision at clause 323A. Treasury sought submissions on this bill during 2013, but work was apparently discontinued following the 2013 election.

The benefit of this approach is that it enables courts and regulators to identify and react to avoidance schemes before consumer detriment occurs. Currently a consumer (and usually a large number of consumers) must suffer detriment before a complaint can reach courts or regulators and it can take a significant period of time before particular business models can be addressed.

The payday lending industry has a long history both in Australia and overseas of developing schemes to avoid consumer protection regulation. Even when legislators draft law with known avoidance techniques in mind (as with the *Enhancements Act*) payday lenders still find weaknesses to exploit. Even assuming Government can close the loopholes it seeks to address through the current exposure draft, it is likely that lenders will continue to find more ways of avoiding the law. A general anti-avoidance provision would enhance ASIC's ability to respond to avoidance as it occurs, making it less likely that we will need further regulatory fine tuning in future.

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

Yours sincerely

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