A consumer advocate's views on Fringe Lending

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What will this presentation cover?

- Regulation – now and future
- Question for fringe lenders
- Current practices – how do they measure up?
- Can fringe lending be fair and responsible?

Regulation – now and future
Current consumer credit regulation

- Credit currently a State constitutional responsibility
- Uniform Consumer Credit Code (**CCC**) covers (most) consumer lending
- Administration slow and fragmented

Regulation – now and future
The future for credit regulation?

- Credit regulation has to go national
- Won't happen overnight, but it will happen!
- No current proposals, but the efficiency benefits are obvious
- Most financial products/services already nationally regulated - *Corporations Act* Ch 7 - FSR regime
- Content-wise, various changes are on the cards, including around reckless lending concerns

Regulation – now and future
Provision of credit is a financial service

- Credit/loan is a financial product
- Provision of consumer credit/lending is a financial service
- BUT not regulated as such under the FSR regime - credit is explicitly excluded
- Many elements of the general FSR regime could work for credit – some tweaking required, but it is an obvious future possibility

Regulation – now and future *Overarching requirement – act honestly and fairly*

- Under FSR regime, all financial service providers must be licensed
- Licensees must do all things necessary to ensure that their services are provided **efficiently, honestly and fairly**
- Licensees must also have a proper internal dispute resolution procedure and be a member of an ASIC-approved external dispute resolution scheme

Regulation – now and future *Overarching requirement – lend responsibly*

- CCC s70 allows courts to reopen loan contracts if they are 'unjust'
- "Unjust factor" s70(2)(l) is whether the lender knew/should have known that the debtor could not repay or not without substantial hardship
- Intention was to make lenders lend responsibly but ongoing reckless lending concerns
- S70(2)(l) duty could be made upfront and more general – eg duty to **lend responsibly** and **offer loan products appropriate to the borrower**

The big question for fringe lenders

- I have been asked to speak to you about compliance with current consumer laws.
- To do this, today I want to ask you some questions in good faith:
  - Would your business comply with a general duty to trade fairly / honestly?
  - Would your business comply with a general duty to lend responsibly (including assessing capacity of the consumer to repay the loan upfront)?

Current practices – how do they measure up?

- Range of current lending practices in fringe lending market sector
- Does your business use them? See if they sound familiar.
- If so, would your business be complying with an obligation to act honestly and fairly or an obligation to lend responsibly?

Current practices – how do they measure up? Avoiding the CCC - business purpose declarations

- An oldie but a goodie!
- Some lenders require borrowers to sign a business purpose declaration - loan is not covered by the CCC
- Don’t worry that borrower’s sole income is social security; or that they’ve never run a business or invested and probably never will
- Borrower could challenge the BPD, but the onus is on them
- Current proposal to remove conclusive nature of BPDs, thanks to these practices

Current practices – how do they measure up?
Avoiding the CCC – promissory notes

- Bill facilities are not covered by the CCC
- Usually a business arrangement - credit provider provides credit by accepting, drawing, discounting or endorsing a bill of exchange or promissory note
- WA consumer lenders started using them for small-amount consumer loans – practice is spreading
- Current proposal to remove exemption of bill facilities

Current practices – how do they measure up?
Avoiding (part of) the CCC – lease, don't loan

- Some lending is to enable borrower to buy a product
- Consumer leases are covered by the Code, but obligations are much less extensive than loans
- "Lease" is still a loan if there is option to purchase the item at end
- So some business only rent items instead – no option to purchase
- But do grant option to purchase "similar" item; or permission to sell item as "agent' and retain most of price as "commission"!

Current practices – how do they measure up?
Avoiding the CCC – no interest charged

- Credit only covered by the CCC if interest is charged
- Some lenders don't charge any interest on their loans – what a good deal for the consumer! But how is the business making any profit…
- Price of the product being bought with the loan is inflated – often hugely so.
- Current consideration of amending CCC to cover inflated purchase prices.
- Business profit could also come from fees…

Current practices – how do they measure up? *Avoiding CCC protections – fees instead of interest*

- Some States have an interest rate cap
- Vic – 48% unsecured, 30% secured; NSW + ACT – 48%
- Qld, SA and WA – can prescribe a max APR but haven’t
- Almost universal practice in the small amount, short-term credit market – reduce the interest rate and charge large fees instead.
- Fees are clearly excessive in comparison to the “costs” they purport to cover, eg application, establishment, maintenance
- NSW – 48% cap now includes fees and charges because of these practices

Current practices – how do they measure up?
Excessive fees – Consumer Action case

- Mr L is 65 years old.
- For at least 6 years, and possibly for many years before that, he has suffered from cognitive impairment. It is readily apparent to the ordinary observer.
- Mr L's sole income is a disability support pension. He does not own any substantial assets.
- In 2006, Mr L entered into a contract for a loan of $750. The contract provided for an admin fee of $750, as well as other fees of $105.16, in addition to interest of 45.5% per annum.

Current practices – how do they measure up?
Take security over household goods

- Mortgages over all property or future property are void – CCC ss40-41
- Some lenders take mortgage over itemised list of borrower's household goods
- No intention of seizing the goods if consumer defaults – what would they do with a bed, a fridge, a couch?
- But threat of doing so enough to force repayment from borrower no matter what
- Well-known that consumer groups want this practice banned
- Current proposal for CCC to prohibit taking security over essential household goods
- We also want proposed PPS Register to be closed to these securities

Current practices – how do they measure up?
Increase client base

- CCC prohibits door to door hawking of credit
- Waltons did this decades ago – sold high cost credit door to door to pensioners
- Good reason to prohibit – recognises the high-pressure tactics used
- *Except* not prohibited if 'by prior arrangement by the credit provider with a person who resides there'
- Recent letter-boxing of households by one provider – then makes an "arrangement" to visit in the home

Current practices – how do they measure up?
Summary

- BPDs
- Promissory notes
- Leases
- Inflated prices and/or Excessive fees
- Blackmail securities
- Letter-boxing with follow-up home visits
- Are any of these consistent with acting honestly and fairly? Lending responsibly?
- If they were, why would each be subject to so much scrutiny and/or real proposals to amend laws to stop them?

Can fringe lending be fair and responsible?

- Before asked: *Would* your business comply?
- Another question: *Could* your business comply?
- Fringe lending deliberately positioned to lend to the low-income/disadvantaged sector of the community
- High risk = high cost

Can fringe lending be fair and responsible?

- Simply servicing a demand?
- Payday lending research: 79% used to compensate for income shortfalls, eg rent, bills
- Payday lending research: 65% are repeat customers, 37% continuous and 15% in a back to back loan cycle
- Loans are not to supplement lifestyle, but to cover financial difficulties

Can fringe lending be fair and responsible?

- Other ways to deal with this “demand”
- Lenders also creating more demand through advertising, letter-boxing etc
- The bottom line: small-amount, short-term credit caters to the poor
- Question for rest of conference: can fringe lending be efficient, honest and fair and lend responsibly in this context?

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