Payday Lending in Victoria - A research report

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The Consumer Law Centre Victoria is one of Australia's leading consumer advocacy and public interest organisations, undertaking research, policy development, advocacy, lobbying, education and public interest test case litigation. The Centre also operates a large consumer legal practice assisting thousands of low-income consumers with free legal advice and representation each year. The Centre's work is focussed on advancing the interests of low-income and vulnerable consumers.

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Lastly I must express my gratitude to the many payday loan consumers whose willingness to share their experiences made this research report possible.

Dean Wilson
June 2002

Preface

The Consumer Law Centre Victoria has been involved in a national campaign to protect consumers from payday lending, and exploitative credit generally, for the past two years. In 2001, the Centre formed the view that a thorough analysis of the explosive growth of payday lending was required. In particular, we were interested in determining who was using payday lenders and why. This information, in our view, is critical. It assists us not only in understanding the growth of payday lending (and other forms of high-cost credit), but also in formulating appropriate regulatory responses to payday lending. Perhaps more importantly though, gathering information on the experiences and needs of consumers might assist us, and others, in developing non-exploitative credit options for low-income consumers.

Ultimately greater disclosure and greater consumer protection (such as interest rate caps), whilst vital, can only go so far. Low-income people need to be able to choose affordable credit options, rather than resort to exploitative credit. This will free low-income consumers from debt traps that arise simply from trying to make ends meet as well as creating the broader sense of financial and social inclusion that comes with having access to sustainable, affordable credit.

The Centre is grateful to the Victorian Consumer Credit Fund for generously funding this report.

Thanks are also owed to the committed staff of the Consumer Law Centre Victoria and, in particular, the author of the report, Dean Wilson. Dean joined the Centre staff in October 2001 for a four month period to research and write this report. Dean joined us having had considerable research and lecturing experience at Monash University and the University of Melbourne. Dean's significant enthusiasm for this project was matched by the research and writing skills to deliver a highly readable, yet rigorous and comprehensive report.

This report is an important contribution to the policy debate surrounding payday lending and the practices of exploitative credit providers. It will also serve a broader function - to encourage and inform the debate about access to affordable credit for low income and vulnerable Australians.

Chris Field
Executive Director
Consumer Law Centre Victoria
28 June 2002

Executive Summary

Introduction

This report sets out and analyses qualitative and quantitative research commissioned by the Consumer Law Centre Victoria in 2001. The report was commissioned in response to concerns about the growth of the payday lending industry in Australia, and the regulation of its participants. The report has been generously funded through a grant from the Victorian Consumer Credit Fund.

The report examines the national and international developments in payday lending and the scale, operation and regulation of the payday lending industry in Australia and, in particular, in Victoria. It presents empirical research on the experiences and needs of payday loan customers.

Information on both the size and the operation of the payday lending industry has been provided by payday lenders, enabling important observations about the payday lending industry to be made.

As there had been no major empirical study of payday lending undertaken in Australia, the report was intended to provide a new contribution to the policy debate surrounding this form of short-term credit – a credible and rigorous analysis of the experience of consumers who use payday lenders. Who chooses to take out payday loans and why? How often? How do consumers see their experiences with payday lenders? This report asks and answers those questions.

Methodology

The research consisted principally of an extensive national and international literature review, interviews with financial counsellors, consumer support workers and other community workers, a telephone survey of payday lending businesses, and both street surveys and in-depth interviews with payday lending customers. The methodology has been designed to provide data that has statistical significance and can be relied upon in formulating policy outcomes.

Findings

Payday Lenders

The findings suggest payday lenders process approximately $10 million in transactions per annum. The industry is characterised by marked volatility and there is a trend towards product diversification with many lenders advertising (although possibly not regularly offering), larger and longer term loans to payday loan customers. As expected, the report finds that annualised interest rates are exceptionally high.

There is considerable variation in the lending criteria established for loans, with some payday lenders insisting upon evidence of customers' pay-slips, and others content to lend money to customers in receipt of a Centrelink payment. Advertising is, however, targeted at low income consumers under financial stress and businesses are located in predominantly socially disadvantaged areas.

Who uses payday lenders and for what reasons?

The report finds that men and women are represented in fairly even numbers in the customer base of payday lenders and are most likely to be in their late 20s or early 30s. The average earnings of payday lending customers is approximately $24,500, with a sizeable portion of customers earning less than $401 per week. The results also illustrate that the majority of payday loan customers are renting with many living in public housing.

Eighty percent of loans are for less than $350 per week and repeat borrowing was high with the majority of customers having borrowed more than once. Loans were typically sought to pay bills or to cover day to day living expenses.

Interestingly, customers reported that they liked the sense of independence, privacy and self esteem that comes with having access to credit otherwise denied to them by mainstream financial service providers. This is consistent with the findings of American research on the use of high-cost credit by consumers. However, the major drawback identified by consumers was the very high cost and the addictive nature of the loans, in part because of the speed with which further loans could be obtained.

Recommendations

On the basis of these results, several policy recommendations have been made. Policy recommendations include:

- Further regulation to ensure that the true cost of credit through a payday lender does not exceed the 48% per annum interest rate cap set out in the Uniform Consumer Credit Code as it applies in Victoria. For the purposes of uniformity, and in the interest of national consumer protection, it is recommended that a 48% interest cap is made uniform throughout Australia as should be “true cost of credit” reforms.
- As part of their social obligations, the entry of the banks to the short-term credit market is imperative. Banks should develop a commercially viable low-interest loan product tailored to the needs of low income consumers who are currently using payday lenders and other fringe credit providers. Such a product would best be developed as a private/public/community sector partnership between the banks, Government and community organisations.
- Expanding the scope of No Interest Loan Schemes to include loans for such items as car repairs, registration and utility bills.
- Increased flexibility in the delivery of Centrelink Advance Payments currently administered by the Commonwealth Department of Family and Community Services.

1. Introduction

This is the first major empirical study of payday lending undertaken in Australia. The report begins with a comprehensive review of the national and international literature on payday lending, then examines the scale and operation of the payday lending industry in Australia and, in particular, Victoria. The report goes on to present the findings of research on the experiences and needs of payday loan customers. The report concludes by making a number of recommendations, including recommendations concerning the regulation of payday lending and the availability of low-interest loan schemes as an alternative to payday lending.

'Payday lending' is the practice of a lender advancing money to a customer until their next pay day in exchange for a fee. Loans are typically for two to four weeks, and many Victorian payday lenders do not give loans over 28 days. Payday loans are also typically unsecured, and for sums of around $250. Rather than interest, borrowers pay a 'fee' on their loan that varies according to the period of the loan. Most loans are repaid through direct debiting the borrower's bank account.

The practice of 'payday lending' requires some definition, as numerous terms are currently employed to describe these loans, including the generic 'short-term loan', 'cash advance' and the industry-preferred term, 'micro-lending'. To avoid confusion, this report uses the terms 'payday lending' and 'payday loan' throughout.

The practice of payday lending has been of considerable concern to consumer advocates, financial counsellors, community workers, and governments, including government regulatory agencies. Since the appearance of payday lending in Australia, consumer advocates have argued that these businesses exploit low-income and vulnerable consumers by leading them into spirals of debt and charging unconscionably high interest rates.

Counter arguments from the Australian payday lending industry have been that they provide emergency cash relief to sectors of the community with few or no other credit options available to them. Furthermore, they have consistently argued that their rates are reasonable when the establishment and administrative costs of loans are taken into consideration.

In a welcome response, and first step in addressing this serious issue, the Uniform Consumer Credit Code now regulates payday loans. Payday loan consumers will, in theory, have available to them sufficient information about the nature of the financial product they are using.

However it must be realised that those using payday loans have little or no market power. Information and disclosure may guard against the most flagrant abuses but do not equate with 'choice' as they commonly do for more affluent consumers. It is vital that the policy debate move towards addressing the fundamental inequity of vulnerable consumers paying vastly higher charges for credit than other consumers.

In Victoria, payday loans are technically subject to a 48% interest rate cap, however it is clear that loans with effective interest charges far in excess of this are still commonplace.

This report aims to inform policy debate by placing payday lending within a broader socio-economic context and by providing empirical evidence on the practice and experience of payday lending in Victoria.

Chapter 2 outlines the methodology used in conducting empirical research into the patterns of consumer use and consumer attitudes towards payday lending in Victoria. Chapter 3 provides an overview of existing research on the topic of payday lending both internationally and within Australia.

Chapter 4 provides both a description and analysis of the growth of payday lending in the United States, Canada and the United Kingdom. This chapter also outlines the various regulatory environments.

Chapter 5 outlines the current extent of the industry in Australia and places it within a broader socio-economic context. Chapter 6 provides a more detailed discussion of the operation and shape of the industry in Victoria.

Chapter 7 provides an analysis of statistics gathered from a street survey of payday loan consumers. These statistics are complimented by an analysis of the findings of 12 in-depth interviews conducted with payday loan consumers presented in Chapter 8.

Chapter 9 concludes the report with a series of recommendations aimed at redressing market failure and restoring equity to the short-term credit sector.

2. Project Outline & Methodology

This project examines payday lending in Victoria. Particular emphasis has been given to assembling a profile of payday lending consumers, and investigating the experience of those consumers. The investigation was informed by a number of key research questions. These were the following:

- *What have been the findings of existing research, both internationally and within Australia, into payday lending?*
- *What is the extent and regulatory environment of payday lending internationally and within other Australian jurisdictions?*
- *What socio-economic factors account for the appearance and expansion of payday lending as a form of credit provision in Australia?*
- *What is the current extent of the payday lending industry in Victoria and what regulatory environment does the industry operate within?*
- *What are the characteristics of payday lending consumers, and what factors lead them to utilise this form of credit?*
- *What is the consumer experience of this form of fringe credit?*
- *What credit provision options would most benefit this group of consumers?*

The project has utilised a combination of qualitative and quantitative methodology. The principal components of research were the following:

- Literature Review;
- In-depth interviews with financial counsellors and community workers;
- Telephone survey of payday lending businesses;
- Street survey of payday lending consumers; and
- In-depth interviews with payday lending consumers

2.1 Literature Review

A comprehensive review of the relevant literature was undertaken, using the archive on payday lending held at the Consumer Law Centre Victoria Ltd, the State Library of Victoria, and Monash and Melbourne University libraries. Searches were undertaken using the Social Sciences, Business and Economics and Law Indexes and the Australian Public Affairs Index.

An advanced internet search was also undertaken, and relevant government, non-profit and commercial sites scanned for relevant information. A manual search was also undertaken to locate relevant articles in the Victorian print media from 1998-2001.

Given the relatively small amount of material devoted exclusively to payday lending, the search examined a broad range of material related to consumer credit, fringe credit and studies of consumer behaviour.

2.2 Interviews with financial counsellors and consumer support workers

Interviews were conducted with 10 financial counsellors and consumer support workers who had some experience or knowledge of payday lending in Victoria. The interviews were semi-structured, therefore allowing participants to raise additional issues or potential avenues of inquiry they considered relevant to the study.[1] The following broad topic areas were covered in each interview:

- The financial circumstances of clients using payday loans;
- The purpose for which clients have obtained payday loans;
- Clients' perceptions of payday lending;
- Difficulties experienced by clients with payday loans;
- Broader social changes impacting upon consumer credit; and
- Future policy options for credit provision for low-income consumers

An outline of the project was also circulated via financial counsellor and community worker networks. As a result, additional case studies and information were communicated to the researcher over the course of the project.

2.3 Telephone Survey

A telephone survey was conducted in early November 2001 of 20 businesses identified as offering payday loans. Of the 20 businesses, 1 was no longer trading, while 1 other business could not be contacted. Therefore data was collected for 18 businesses in Melbourne and Geelong.

The telephone survey sought to establish:

- Identification required to obtain a loan;
- The period of time within which a loan could be obtained;
- The sum repayable on a loan of $200 over a period of 2 weeks;
- Whether the excess on this repayment was termed 'interest';
- If direct debit was required;
- If the repayment date could be extended; and
- If loans were approved for persons receiving Centrelink benefits

The results of the survey allow a comparative analysis of business operation in the Victorian payday lending industry.

2.4 Street Survey

Payday loan consumers are a difficult to access population. It was therefore decided that the best method for assembling a profile of the characteristics of payday loan consumers was to conduct a street-based survey in the vicinity of payday lending businesses.

A survey was developed which questioned consumers about their loans and demographic details. The full survey is included as Appendix A, however the questions included:

- Size and length loan;
- The purpose of the loan;
- If they had had any previous loans and if so, how many; and
- Other forms of credit used in the past 12 months

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[1] On the advantages of the semi-structured interview techniques see T. May 1997, *Social Research: Issues, Methods and Process*, 2nd edition, Open University Press: Milton Keynes, pp. 111-112.

Section B of the survey gathered data on gender, age, marital status, size and source of income, education, housing, place of birth and language.

To maximise response rates, the questionnaire was designed to be concise. The survey consisted entirely of factual questions, with the final version taking three to 5 minutes to complete. Timing was of great importance, as interviews were conducted in the street where participants were unlikely to participate in a lengthy questionnaire. Obviously this involved some balancing and compromise between brevity and potential data. Nevertheless, it was reasoned that the opinions and experience of payday loan consumers would best be obtained through in-depth interviews.

The importance of piloting surveys is often commented upon. Piloting, or pretesting, is recommended to ensure questions are appropriate, clearly understood by participants and provide valid data for the overall research for purpose.[2] Two sessions of survey pretesting were carried out to ascertain interview length and participant response, resulting in minor, though useful, amendments to the original questionnaire.

There was some apprehension prior to testing that consumers might be unwilling to answer questions relating to their personal finances. While much thought was given to making the questions as discreet as possible, this concern turned out to be unfounded. Payday loan consumers are a candid demographic. Participation rates were extremely high, and while no actual figures were collected, feedback from street researchers suggests that refusals were as low as 1 in 4. Similarly, there was little problem of non-response to survey questions, and once participants had agreed they generally completed the survey.

Street research contains an inherent element of risk, and therefore researchers were issued with a set of safety guidelines for conducting the survey.[3] Researchers were also briefed by the principal researcher on techniques for street interviewing and strategies for handling difficult situations.

In any event there were no significant safety difficulties encountered in fieldwork. A far greater research problem was the slowness of conducting the survey. Street researchers soon reported that trade at payday lending businesses was frequently slow, with 1-2 customers per hour being common. This resulted in the survey timeframe being expanded, and the fieldwork was conducted from November 2001 to January 2002. Researchers targeted 11 locations.

- Brunswick;
- Collingwood;
- Croydon;
- Dandenong;
- Frankston;
- Geelong;
- Glenroy;
- Greensborough;
- Huntingdale;
- Northcote; and
- Springvale

These locations included shopfront operations of *Money Plus*, *ChequEXchange* and *AMX*.

Overall the average was 1 completed survey per hour, with 3 completed surveys in 1 hour being the highest number achieved. The final number of completed questionnaires was 78, with 72 being consumers applying for or repaying payday loans. This provided a useful sample of consumers.

[2] C.T. Mowbray & M. Yoshihawa 2001, ‘Surveys’ in B. Thyer (ed.), *The Handbook of Social Work Research Methods*, Sage: Thousand Oaks, pp. 150-51.
[3] G. Craig, A. Corden & P. Thornton 2000, ‘Safety in Social Research’, *Social Research Update*, 29, Summer <http://www.soc.surrey.ac.uk/sru/SRU29.html>

2.5 In-depth Interviews

The quantitative data generated by the street survey was complemented by qualitative information gathered from in-depth interviews with payday loan consumers. Given the hidden nature of the payday loan consumer population, there was a significant issue about how to access research participants. Referrals from financial counsellors were not favoured as it was considered such a sample would be too biased to be valid.

It was considered that the best method of accessing participants would be via kerbside recruiting. Kerbside recruiting has been shown to be particularly appropriate for accessing 'invisible' populations.[4] Recruitment for in-depth interviews took place between November and December 2001, and was carried out by researchers administering the street questionnaire.

Some 23 participants in the street survey indicated their willingness to participate in an in-depth interview. Due to the constraints of time and resources, participants were then selected using several criteria. Broadly, participants were chosen to provide a reasonable cross-section of those using payday loans. Therefore income source, age, gender and number of loans informed the selection process. As has been noted in assembling an in-depth interview sample, accessing and determining the important characteristics of informants is the most important task, not developing a large sample size.[5]

A total of 12 interviews were conducted with payday loan consumers. This number represented an appropriate number for the purposes of the project. Eleven participants were recruited through the street questionnaire, while 1 further in-depth interview was conducted with a consumer referred from a financial counsellor.

Interview participants received a reimbursement of $30 to cover costs associated with attending the interview. Additionally, the reimbursement recognised the valuable contribution made by participants in sharing their knowledge and experiences with the researcher.[6] Eleven interviews were conducted in Community and Legal Centres in locations most convenient for participants. However 1 interview was conducted in a workplace at the suggestion of the participant. The average length of the interviews was about fifty minutes, with some slightly shorter and some considerably longer, largely dependent upon the participants' responses.

Before commencing interviews, the purpose of the research was explained to participants. To avoid exerting any influence upon the responses of participants, the interviewer avoided expressing any opinion about payday lending either before or during interviews. As the subject matter is highly personal, it was also explained to participants that their identity would remain anonymous, and that their personal details would remain strictly confidential.

Having received an explanation of the project and the conditions of the interview, participants then signed a consent form. To protect the identities of participants each was invited to choose a pseudonym. Each interview audiotape and transcript was then coded, with the identity and contact details of the participant known only to the principal researcher[7].

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[4] J. Browne 1999, 'Kerbside Recruiting: Issues of rigour in using an innovative technique for recruiting qualitative research participants', *Paper presented to AQR Issues of Rigour in Qualitative Research Conference*, July 8-10, Melbourne, Australia http://www.latrobe.edu.au/aqr/offer/papers/Jbrowne.htm (accessed 20 October 2001).

[5] H. Goodman 2001, 'In-Depth Interviews' in B. Thyer (ed.), *The Handbook of Social Work Research Methods*, Sage: Thousand Oaks, pp. 314-315; see also S. Kvale 1996, *InterViews: An Introduction to Qualitative Research Interviewing*, Sage: Thousand Oaks, p. 102.

[6] S. Thompson 1996, 'Paying respondents and informants', *Social Research Update*, 14, Summer <http://www.soc.surrey.ac.uk/sru/SRU14.html>

[7] All records of interviews with participants and associated data have been kept securely for a period of 5 years, following which they will be destroyed.

Interviews were semi-structured, allowing the interviewer to probe beyond the initial responses of participants.[8] The interviewer covered a range of topic areas in each interview rather than using fixed questions. The interviewer asked questions of participants that covered the following topics:

- The circumstances leading up to applying for their first payday loan;
- Where they had first become aware of payday loans;
- The purpose of their payday loans;
- Experience of obtaining payday loans;
- Perceptions of charges;
- Perceptions of payday loans in relation to other credit options; and
- Their views on available credit options and potential alternatives.

[8] May 1997, above note 1, p. 111.

3. Existing Research

Despite the prominence of payday lending as a media and public policy issue the body of research devoted to the topic remains small. The main studies of payday lending have emerged from the US, understandably perhaps as the US has the largest payday lending industry and 1 which has continued to expand.

While no empirical studies of payday lending have yet been undertaken outside of the US, the topic has been discussed in broader studies of fringe credit and low-income consumers in Canada, the United Kingdom and Australia.

This section outlines research undertaken in the United States, Canada, United Kingdom and Australia dealing with fringe credit and bearing upon the practice of payday lending.

3.1 United States of America

Although there had been some research conducted on loan sharking in the 1940s in America, serious studies of fringe credit did not re-emerge until the late 1980s. John P. Caskey, a Professor of Economics at Swarthmore College, Pennsylvania, completed pioneering research examining pawnbroking and cheque cashing outlets. Caskey's initial research was carried during his time at the Federal Reserve Bank of Kansas City, and has spawned numerous articles and 1 monograph.[9]

Amongst the important contributions of Caskey's research, was that he sought to explain the rise of check cashing outlets and pawnshops in terms of broader socio-economic change and transformations in the financial sector. Caskey argued that the expansion of fringe credit could be attributed to the increasing social polarisation resulting from stagnating real wages amongst lower income groups. This, Caskey argued, was compounded by the withdrawal of banking services from the poor leaving a void in the credit market filled by alternative credit providers.

While Caskey's research provided an invaluable model for future research, his work predated the appearance of payday lending in the United States in the mid-1990s. In the early and mid 1990s check cashing outlets and pawnbroking outlets were also the major focus of studies of fringe credit.[10]

Consumer advocates rather than academic economists or social scientists conducted initial research into payday lending in the United States. In 1997 the Consumer Federation of America (CFA) published a report on check cashing and payday loan practices arguing that state consumer protection was inadequate and consumers lacked the power to make informed decisions.[11]

In 1998 a follow up report was produced by Jean Ann Fox, CFA Director of Consumer Protection, examining the regulatory status of payday lending, loan terms offered in 8 states, and offering policy recommendations and advice to consumers. The report furthermore argued payday lending targeted vulnerable consumers and placed them on a 'debt treadmill' as they were able to 'rollover' loans.[12] Fox also

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[9] John P. Caskey 1991, 'Pawnbroking in America: The Economics of a Forgotten Credit Market', *Journal of Money, Credit and Banking*, 23/1; Caskey 1994, *Fringe Banking: Check Cashing Outlets, Pawnshops and the Poor*, Russel Sage Foundation: New York; J. Caskey & B. Zikmund 1990, 'Pawnshops: The Consumer's Lender of Last Resort', *Economic Review*, March/April, pp. 5-18.

[10] For other studies see for example Mary Kane, '"Fringe Banks" profit from Customers without Banks' in Michael Hudson (ed.) 1996, *Merchants of Misery: How Corporate America Profits from Poverty*, Common Courage Press: Maine; Robert Minutaglio, 'Prince of Pawns' in Hudson 1996.

[11] Consumer Federation of America 1997, *The High Cost of 'Banking' at the Corner Check Casher: Check Cashing Outlet Fees and Payday Loans*, Consumer Federation of America: Washington D.C.

[12] Jean Ann Fox 1998, *The Growth of Legal Loan Sharking: A Report on the Payday Loan Industry*, Consumer Federation of America, http://www.stateandlocal.org/loanshar.html

discussed the emerging regulatory environment and the need for effective rate regulation to protect vulnerable consumers in an article published in 1999.[13]

The CFA released an even more comprehensive report in February 2000, surveying 230 payday lenders in 20 States. The report outlined the existing regulatory environment in all states and made recommendations for future legislative initiatives. In addition the report reiterated the arguments of earlier CFA reports, that payday loan charges were extortionate, loans were designed to trap borrowers in perpetual debt and that the industry was adopting coercive collection practices.[14]

Consumer organizations and Public Interest Research Groups (PIRGs) have continued to undertake research into payday lending as part of their advocacy role. Mostly these have had a legislative and policy emphasis. The National Consumer Law Centre released a policy paper in 2000 outlining strategies for lobbying for legislative change and including a model of preferred legislation.[15] Policy documents have also been prepared by the AAPR and the Woodstock Institute.[16] Consumer lobbyists in both Colorado and North Carolina have also produced reports on payday lending in their respective states advocating changes to state law.[17]

In 2000 the Community Reinvestment Association of North Carolina published a collection of articles on the subject of payday lending. The collection aimed to represent the gamut of opinion on the subject, and included borrowers' stories, and opinions of industry representatives, academics, government bureaucrats and community workers.[18]

State authorities in the USA have also conducted research into payday lending, and studies of transactions and customer base have been undertaken in Indiana, Iowa and Illinois. The report on short-term lending prepared by the Illinois Department of Financial Institutions is of particular interest as it assembled a profile of the customers. The general finding of the report was that the average Illinois payday loan borrower was a woman in her middle thirties earning $24 000 a year.[19]

Research into the customer base and borrowing patterns in the payday lending industry has also been carried out in the State of Wisconsin. Despite the report's clearly anti-regulation stance, the findings on the average income of borrowers were broadly similar to those of the Illinois report. The report found that average customers were female, the average age was 39, and average individual incomes were $18 675 net or $24 673 gross. Somewhat illogically, and without reference to any further data, the report then concludes by stating that borrowers are drawn from 'a broad spectrum in terms of age and gender'.[20]

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[13] Jean Ann Fox 1999, *Safe Harbour for Usury: Recent Developments in Payday Lending*, Consumer Federation of America: Washington D.C.

[14] The PIRGs and Consumer Federation of America 2000, *Show me the Money! A Survey of Payday Lenders and Review of Payday Lender Lobbying in State Legislatures*, February, http://www.pirg.org/reports/consumer/payday/showmethemoneyfinal.pdf

[15] National Consumer Law Centre (NCLC) 2000, *Payday Loans: A Form of Loansharking*, http://www.consumerlaw.org/PayDayLoans/pay-menu.htm

[16] AAPR 2001, *The Policy Book: AARP Public Policies 2001*, Chapter 12, http://www.aarp.org/ppa/chapter12.pdf (accessed 30 October 2001); Woodstock Institute 2000, 'Unregulated Payday Lending Pulls Vulnerable Consumers into Spiralling Debt', *Reinvestment Alert No. 14*, March, http://www.woodstockinst.org/Alert.pdf (accessed 18 October 2001)

[17] E. Hoopes 2001, *Small Loans – Big $Money$: A Survey of Payday Lenders in Colorado and Review of the Colorado Deferred Deposit Loan Act of 2000*, Colorado Public Interest Research Group; P. Skillern 2001, *How Payday Lenders Make Their Money*, Community Reinvestment Association of North Carolina.

[18] Community Reinvestment Association of North Carolina 2000, *Too Much Month at the End of the Paycheck: Payday Lending in North Carolina*, Community Reinvestment Association of North Carolina: Chapel Hill.

[19] Illinois Department of Financial Institutions 2000, *Short Term Lending: Final Report*, Illinois Department of Financial Institutions http://www.state.il.us.dfie/publications.html (accessed 20 October 2001)

[20] State of Wisconsin Department of Financial Institutions 2001, *Review of Payday Lending in Wisconsin 2001*, State of Wisconsin Department of Financial Institutions:
http://www.wdfi.org/resources/indexed/site/newsroom/press/payday_loan_may_2001.pdf
(accessed 20 October 2001)

Despite robust public debate on the subject, in the US few studies of payday lending have yet been undertaken by academics. However an article published in the 2000 *Alabama Law Review* outlines the current regulatory environment in the US and discusses several significant legal cases with implications for the industry.[21] L. Drysdale and K. Keest also analyse the current legal situation across the alternative financial (or "sub-prime" as it is known in the US) sector, giving considerable attention to payday lending.[22]

The payday lending industry in the US has also funded 1 major research project. The Community Financial Services Association of America, the peak body representing the payday lending industry, funded the McDonough School of Business, Georgetown University to carry out research into consumer demand for short-term loans. Gregory Elliehausen and Edward Lawrence, 2 devoted free market economists, carried out the research. The study is subsequently underpinned by the authors theoretical stance that 'most economists would recommend allowing market competition to determine the price of payday advance credit'.[23]

The monograph explicitly avoided the question of whether the cost of payday advance credit was too high. The study concentrated on customers' awareness of charges and annual percentage rates, the frequency of loan renewals, length of custom and availability of alternative sources of credit and customers experiences with past due date loans. Although clearly pro-industry, the report provides some useful data on consumers.

The most recent research on payday lending has again emerged from Consumer advocates. The Consumer Federation of America (CFA) and the U.S. Public Interest Research Group (PIRG) released a report in November 2001. The report updates earlier research by the CFA on the legal and legislative status of payday lending in the US. The developing trend of payday lenders forming partnerships with banks to evade state legislation is also noted. The report also contains a survey of 235 payday lenders in 20 states and the District of Columbia comparing results with the 2000 CFA *Show Me the Money!* report.[24]

Another recent article also examines the issue of repeat borrowing by payday loan consumers. Research conducted in North Carolina found significant problems of chronic borrowing, and the article makes recommendations for legislative changes to reduce endemic debt spirals.[25]
While the literature from the US is extensive, it has been almost exclusively focused on inter-state differences in regulatory environments. There remain significant gaps in the research focusing on consumer perceptions, motivations and experience. There is also a dearth of material discussing the socio-economic context of payday lending.

3.2 Canada

While there is significantly less work in Canada on payday lending than in the US there are a number of significant studies. The most notable is a report produced by Professor Iain Ramsay of Osgoode Hall Law School Toronto, a leading focus scholar in the area of Consumer Credit.

In 2000 Ramsay published a detailed report prepared for Industry Canada and the Ministry of Attorney. Ramsay's report outlined the size and character of the alternative financial sector in Canada, the socio-

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[21] L. Moss 2000, 'Modern Day Loan Sharking: Deferred Presentment Transactions and the Need for Regulation', *Alabama Law Review*, 51/4, pp. 1725-1745.
[22] L. Drysdale & K. Keest 2000, 'The Two-Tiered Financial Services Marketplace: The Fringe Banking System and its Challenge to Current Thinking about the Role of Usury Laws in Today's Society', *South Carolina Law Review*, 51, pp. 589-669.
[23] G. Elliehausen & E.C. Lawrence 2001, *Payday Advance Credit in America: An Analysis of Customer Demand*, Monograph No. 35, April, Credit Research Centre, McDonough School of Business, Georgetown University: Washington D.C; for quotation see p. 10.
[24] Consumer Federation of America (CFA) and the U.S. Public Interest Research Group (PIRG) 2001, *Rent-A-Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections*, CFA/PIRG, November, http://www.pirg.org/reports/consumer/payday/reports/2001/ (accessed 11 December 2001)
[25] M.A. Stegman & R. Faris 2002, *Payday Lending: A Business Model that Encourages Chronic Borrowing*, First Draft, January, Centre for Community Capitalism: Chapel Hill NC.

economic factors fuelling the expansion of the sector and discussed the growth of consumer vulnerability. The report also contained recommendations for future policy and research directions, which built upon Ramsay's earlier work on consumer credit and distributive justice.[26]

Ramsay concluded his report by stating that the public policy challenges were 'to ensure the needs of vulnerable consumers are met in a less costly manner, to regulate abusive practices effectively, and to ensure that individuals in the alternative financial sector receive a similar level of protection to middle income consumers'.[27]

The Public Interest Advocacy Centre (PIAC) based in Toronto is also currently undertaking research into the alternative financial sector. The research is being conducted by Grant Insights, and 1 discussion paper has been released. The paper discusses the results of focus groups held in Vancouver, Calgary and Toronto with alternative financial sector consumers. The researcher also interviewed a former employee of a payday lending franchise and a former middle manager in order to gain insight into the business practices of payday lenders and how these impact upon consumer behaviour.

Focus groups discussed use of alternative financial sector, how often used and general impressions and experiences of the sector. The results presented in the discussion paper suggest payday lenders profit from consumers who are in financial crisis or lack financial literacy. The author also suggests considerable complexity however as customers were often satisfied with the service they received. The discussion paper will form part of a more comprehensive report to be released by PIAC in mid 2002.[28]

3.3 United Kingdom

While there are no studies of payday lending for the UK there is a considerable literature dealing with credit, debt and financial exclusion. The Policy Studies Institute published a significant study of credit and debt patterns across a range of social groups in 1992.[29] Rowlingson also covers the extent of moneylenders in the UK and their widespread use by low-income and vulnerable consumers. Rowlingson's study also detailed the high costs borne by consumers forced out of mainstream financial services.[30]

An important study by Kempson in 1994 examined the difficulties of living on a low income and includes discussion of access and use of consumer credit amongst low-income consumers. Kempson's study found those on low-incomes used credit for consumer goods, household necessities, to smooth peaks and troughs in income and pay bills and other debts. Kempson also noted that 'the pressures of a consumer society are not lessened by living on a low income' and reported inadequate income and lack of access to credit excluded many from full participation in society.[31]

A 1996 article published by Ford and Rowlingson also discusses the credit patterns of low-income households, arguing that debates about financial exclusion in the UK have been narrowly drawn and institutionally focused. The paper presents results from research into moneylenders and mail order credit, noting that poor households are further impoverished by reliance on extortionate credit.[32]

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[26] Iain Ramsay 2000, *Access to Credit in the Alternative Consumer Credit Market*, Office of Consumer Affairs, Industry Canada/Ministry of Attorney General, British Columbia, February http://www.strategis.ic.gc.ca/pics/ca/ramsayen.pdf (accessed 18 October 2001); for earlier discussion of consumer credit and distribute justice see I. Ramsay 1995, 'Consumer Credit Law, Distributive Justice and the Welfare State', *Oxford Journal of Legal Studies*, 15/2, Summer, pp. 177-197.
[27] Ramsay 2000, above note 26, p. 40.
[28] M. Grant 2001, *Alternative Financial Services in Canada: Findings from Focus Groups*, Discussion Paper, September, Grant Insights: Toronto.
[29] R. Berthoud & E. Kempson 1992, *Credit and Debt: The PSI Report*, Policy Studies Institute: London.
[30] K. Rowlingson 1994, *Moneylenders and their Customers*, Policy Studies Institute: London.
[31] E. Kempson 1994, *Life on a Low Income*, Joseph Rowntree Foundation: York.
[32] J. Ford & K. Rowlingson 1996, 'Low-income households and credit: exclusion, preference and inclusion', *Environment and Planning A*, 28/8, August, pp. 1345-1360.

There is a comprehensive literature on financial exclusion in the UK surveyed in the Financial Services Authority publication *In or out? Financial Exclusion: a literature and research review*.[33] The report summarises existing research into the use of alternative services, finding that consumers fall into 2 broad categories—those with poor credit histories or a history of bad debt and people living on low incomes. The growth of the alternative financial sector in the 1990s is also noted and mention is made of the recent appearance of cheque cashers in the UK.[34]

The UK Department of Trade and Industry has also commissioned the Personal Finance and Research Centre of the University of Bristol to conduct research into extortionate credit. The final report includes an outline of the alternative financial sector in the UK, a profile of consumers in the sector and discussion of existing legislation. The report includes brief mention of the growing payday loan market, noting that little data on the industry in the UK is currently available.[35]

3.4 Australia

There is presently only a small literature on payday lending in Australia, although there are several studies dealing with alternative financial services more broadly. Studies of both low-income consumers and credit use and the short-term credit market were undertaken in the early 1990s.[36] There have also been 2 studies of pawnbroking undertaken by Good Shepherd Youth and Family Services.[37]

The Queensland Office of Fair Trading prepared an issues paper on fringe credit in 1999. The report included empirical data on loan shark lending in Queensland, finding those borrowing from loan sharks were largely excluded from mainstream consumer credit.

The report also noted the expansion of fringe credit was linked to a growing number of people suffering from socio-economic disadvantage and the withdrawal of services for low-income consumers by mainstream credit providers.[38]

The relationship of fringe credit and problem gambling, and the need for increased regulation of fringe credit providers are the subject of a 2000 conference paper delivered by Simon Cleary, author of the Queensland OFT fringe credit report.[39]

The appearance of payday lending has stirred considerable concern amongst consumer advocates and a number of articles on the subject have appeared in consumer publications. Cleary covers the legal status, high charges and potential for borrower over-commitment with payday loans in an article on fringe credit.[40] Kreet (2000) raises similar concerns and recommends amendments to the Consumer Credit Code.[41]

The Queensland Office of Fair Trading has published 1 major report on payday lending. The report resulted from a working party established to investigate the extent of payday lending market, lending practices, real

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[33] Financial Services Authority (FSA) 2000, *In or out? Financial Exclusion: a literature and research review*, FSA: London.

[34] FSA 2000, above note 33, pp. 41-45.

[35] E. Kempson & C. Whyley 2000, *Extortionate Credit in the UK*, Department of Trade and Industry: London.

[36] J. Chalmers & B. Prosser 1990, *Credit to the Community: Low-cost lending and consumer credit reform*, Brotherhood of St Laurence: Melbourne; C. Cheah & S. Singh 1993, 'Secondhand Credit: Risk, Price and Information in the Regulated Small Loans Market in Victoria', CIRCIT, *Policy Research Paper No. 32*.

[37] K. Densley & V. Ayres-Wearne 1997, *Fair Dealing? The Consumers' Experience of Pawnbroking in Victoria*, Good Shepherd Youth and Family Service/Financial & Consumer Rights Council: Melbourne; V. Ayres-Wearne 2000, *Money Lenders or Loan Sharks: The consumers' perspective on the impacts of deregulation of the pawnbroking industry*, Good Shepherd Youth and Family Services: Melbourne.

[38] Queensland Office of Fair Trading 1999, *"Fringe" Credit Provider — A Report & Issues Paper*, QOFT: Brisbane.

[39] S. Cleary 2000, 'Consumer Law and Fringe Credit Providers' *Conference paper delivered to 3rd National Gambling Conference*, Sydney, 11-12 May.

[40] S. Cleary 1999, 'Loan Sharks bite at the fringe', *Consumer Rights Journal*, November/December, pp. 9-11.

[41] L. Kreet 2000, 'When pay day becomes pay-back day', *Consumer Rights Journal*, May/June, p. 2.

cost of loans, types of consumer borrowing, and to make recommendations for the regulation of payday lending. The working party was comprised of representatives from the legal profession, mainstream credit providers, government, financial counsellors and academia.

The working party heard submissions from payday loan industry representatives and consumer advocates. The final report considered a number of options for regulating payday lending ranging from status quo to total prohibition. The final recommendations of the report were that payday lending should be brought within the Consumer Credit Code, but without an effective interest rate cap as exists in New South Wales, Victoria and Australian Capital Territory.[42]

The Queensland Parliamentary Library has also prepared a research brief summarising the issues surrounding payday lending and outlining proposed amendments to Queensland legislation.[43]

The rapidly evolving regulatory environment in Australia has received some recent discussion, as has the broader socio-economic context and the need to find viable alternatives to payday lending.[44] Nevertheless there remain significant gaps in our understanding of the needs, perceptions and motivations of payday loan consumers.

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[42] Queensland Office of Fair Trading 2000, *Payday Lending—A Report to the Minister of Fair Trading*, QOFT: Brisbane http://www.consumer.qld.gov.au/scripts/publications.exe. The Western Australian Government has recently announced that it will be embarking on pubic consultation in respect of the introduction of an interest rate cap for credit provided under the Uniform Consumer Credit Code.

[43] K. Sampford 2001, *Regulating Pay Day Lending: The Consumer Credit (Queensland) Amendment Bill 2001*, Research Brief 14/01, QPL: Brisbane.

[44] C. Field 2002, 'Payday lending – an exploitative market practice", 27(1) *Alternative Law Journal*, 36, Consumer Law Centre Victoria Ltd. 2000, 'Payday Lending—The Sharks are Circling', *e-bulletin no. 12*, October, http://www.vicnet.net.au/~clcv/News/ebulletin/e-bulletinOct2000.htm; C. Field 2001, 'Market practices that exploit the growth of poverty in our community—A report on pay day lending' *Paper presented to VCOSS Social Policy Congress*, Melbourne 10-12 October.

4. Payday Lending: The International Context

The emergence and expansion of payday lending as a form of fringe credit in Australia parallels similar developments in other Western industrialised nations. Although there are minor differences in the market players, USA, Canada and the United Kingdom have all experienced significant growth in the alternative financial sector of which payday lending is the newest entrant.

Factors common across national boundaries offering some explanation for this phenomenon include:

- Deregulation of the mainstream banking industry and withdrawal of services from low-income consumers;
- Stagnating or declining real incomes amongst low-income earners in a globalised economy;
- Rising levels of credit use across social strata; and
- Increasing levels of household debt and bankruptcy

These factors are discussed in more detail in section 4.4 of this chapter. Firstly, however, this report will outline the national context of payday lending in the USA, Canada and the United Kingdom.

4.1 USA

Payday lending in the USA has experienced explosive growth since the mid 1990s. The exact size of the industry in America cannot be conclusively determined as no federal agency collects comprehensive data and few state jurisdictions publish industry data. Nevertheless, all available evidence suggests that payday lending is big business. A Senior Vice President of Stephens Inc, an investment firm based in Little Rock, Arkansas, recently claimed that the turnover of the payday lending industry for 2000 involved 65 million transactions to 8 to 10 million American households, generating $2.4 billion dollars in fee revenue.[45]

The rise of payday lending operations in the US has been nothing short of spectacular. The state of Illinois went from having no payday lenders in 1995 to having 500 by 1999. Similar explosive growth is reported in other states.[46] From a handful of outlets in the early 1990s there are now estimated to be between 10 000 and 12 000 payday lenders across America.[47]

Payday loans are provided by stand-alone businesses, check cashing outlets and pawn shops and also via faxed applications, online and via toll-free telephone numbers. The largest stand-alone companies are Advance America, Check N' Go, Check into Cash and United Credit Services. Several large check-cashing chains also offer payday loans including ACE Cash Express, Dollar Financial and QC Financial.[48] There are also a multitude of smaller operators although there has recently been consolidation in the US industry.[49]

American payday loans usually take the form of a 'deferred presentment transaction'. This refers to the practice whereby the lender accepts a post-dated check from the borrower and in return advances a cash loan. The borrower may then pay the lender in cash and have the check returned, or the lender may deposit the check to retrieve the amount lent.

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[45] Consumer Federation of America/U.S. Public Interest Research Group 2001, *Rent-A-Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections*, CFA/PIRG, November, p. 6.
[46] Woodstock Institute 2000, 'Unregulated Payday Lending Pulls Vulnerable Consumers Into Spiralling Debt', *Reinvestment Alert No. 14,* p. 1; for growth in Wisconsin see S. Meili 2000, 'CPR's Advocacy on Pay-Day Loans Pays Off', *The Public Eye*, 25/3/4, Spring/Summer, http://www.law.wisc.edu/pal/pubeye2.htm#story_8 (accessed 22 October 2001)
[47] CFA/USPIRG 2001, above note 45, p. 6.
[48] CFA/USPIRG 200, above note 45, p. 6.
[49] Woodstock Institute 2000, above note 46, p. 1.

The explosive growth of payday loans in the US can be attributed to the deregulation of the banking industry, the absence of traditional small loan providers from the small-sum, short-term credit market and the elimination of interest rate caps in many US states. Deregulation of banking in the 1980s prompted banks to eliminate less profitable services, such as small balance bank accounts and free checking accounts, leaving millions of low-income US households with no access to low cost financial services.[50]

4.1.1 Regulatory Environment (USA)

Payday lending in the US is regulated at a state rather than federal level. US state legislatures have adopted 3 basic approaches to payday lending:

- Payday loan laws that explicitly authorise and regulate payday lending;
- Prohibition of payday loans; and
- No regulation

Nineteen US states and the District of Columbia have specific payday loan regulations that exempt payday lenders from state usury laws. These laws generally stipulate a maximum loan amount, a maximum term and fees. Lenders are also required to be licensed or register with state regulators. Some state laws also limit paying 1 loan with an additional loan and rolling over debt.[51]

Payday loans are prohibited in 18 US states and the territories of Puerto Rico and the Virgin Islands. Prohibition is achieved through small loan laws setting maximum interest rates well below those charged for payday loans. Check cashing laws prohibiting cashing or making loans upon post-dated checks are also in force.

Twelve states currently have no limits on small loan interest rates thereby permitting payday loans by omission.[52]

Cases bringing the legality of payday lending into question have also been heard in state Supreme Courts. The Kentucky Supreme Court ruled in 1999 that payday loans made in the state prior to 1998 were illegal as they were disguised loans.[53]

In 2001 the Arkansas Supreme Court ruled that if a payday cash advance was in fact a loan it was in violation of the State Constitution. The Indiana Supreme Court ruled in August 2001 that Indiana's 36% small loan interest cap and criminal loan sharking law applied to payday loans, rendering the industry in violation of state criminal and civil law.[54]

Several US federal laws also impact upon payday lending. As consumer loans payday loans are subject to the federal *Truth in Lending Act* (15 U.S.C. §1601), implemented by the Federal Reserve Board's Regulations Z. Truth in Lending requires disclosure of the price and other terms of consumer credit transactions.

The implications of the federal *National Bank Act* (12 U.S.C §§ 85-86) are more controversial. US courts have held that the *National Bank Act* allows federally insured banks to charge the higher of the interest rate allowed in the state where the bank is domiciled or 1% above the discount rate on 90-day commercial paper in the Federal Reserve district in which the bank is located.[55]

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[50] L. Blaylock Moss 2000, 'Modern Day Loan Sharking: Deferred Presentment Transactions & the Need for Regulation', *Alabama Law Review*, 51/4, p. 1732

[51] Moss 2000, above note 50, pp. 1739-40.

[52] Moss 2000, above note 50, pp. 1740-41; for further discussion of individual state legislation see CFA/USPIRG 2001, above note 45, pp. 11-12; Elliehausen & Lawrence 2001, above note 23, pp. 5-7.

[53] Fox 1999, above note 13, p. 2; White v Check Holders, Inc., 996 S.W. 2d 496, 500 (Ky 1999)

[54] CFA/USPIRG 2001, above note 45, p. 11 & p. 16.

[55] Elliehausen & Lawrence 2001, above note 23, p. 7.

The result is that nationally chartered banks are able to export interest rates charged in their home state to customers in other states. There has subsequently been an expansion of the practice of payday loan companies forming alliances with federally insured banks to evade state legislation.[56]

The industry trade association, the Community Financial Services Association of America, also advocates the cause of industry self-regulation. In 2000 the CFSA released a 10-point 'Best Practices' standard for the industry. The 'Best Practices' cover areas such as disclosure, truth in advertising, consumer education, the right to rescind contracts and debt collection practices.[57]

4.2 Canada

Canada has also experienced a rise of payday lending and a rise in the size of the alternative financial sector generally.[58] The growth of the alternative financial sector in Canada can be attributed to several factors. Canada has experienced a growth in income inequality, declining savings to income ratios, and increasing debt-to-income ratios. There has also been a rise in personal bankruptcy with 4 times as many bankruptcies in 1998 as in the mid 1980s. Like other western industrialised nations, changes in mainstream financial services in Canada have also disadvantaged low-income consumers.[59]

There is no available data on the current size of the Canadian payday lending industry. The industry is more consolidated than that of the US, with companies such as Money Mart, Stop 'n' Cash and Financial Stop being the major payday lenders.

Money Mart was the earliest entrant to the industry and has retained a pre-eminent market position.[60] Money Mart currently has 250 storefront operations across Canada and claims to have 1 million customers conducting $2 billion in transactions annually. The company's promotional material explicitly contrasts its services with those of mainstream financial providers stating that it is 'not your typical financial services business' as every branch has 'a bright casual atmosphere where customers are greeted by name'.[61]

Transactions in Canada are the same as for the US, and use either a post-dated check including the lender's charge or a direct debit from the borrower's bank account. A survey of payday lenders carried out in the Toronto area also indicates interest charges analogous with those of the US, APRs being between 335% and 1300%.[62]

4.2.1 Regulatory Environment (Canada)

Payday lending in Canada remains unregulated although provincial consumer protection laws have some impact upon the industry. All provinces have some form of consumer protection legislation regulating disclosure in credit contracts and the advertising of fees and conditions of credit.[63]

Several Canadian provincial jurisdictions also provide legal remedy for excessive credit charges through *Unconscionable Transaction Relief Acts* that provide for the reopening of unconscionable credit contracts.[64]

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[56] PIRGs/CFA 2000, above note 14, pp. 12-14; J. Johnsson 2000, 'Bank's bid for payday loan riches', *Crain's Chicago Business*, 14 January, 23/7, p. 1;
[57] Elliehausen & Lawrence 2001, above note 23, pp. 8-9; the guidelines are reproduced in full as Appendix A, p. 61; see also B. Rehm 2000, 'Payday Lenders try standard approach to respectability', *American Banker*, 24 January, 165/15, p. 3.
[58] Ramsay 2000, above note 26.
[59] Ramsay 2000, above note 26, pp. 1-3.
[60] Grant 2001, above note 28.
[61] http://www.moneymart.ca , see also http://www.stopncash.com
[62] Ramsay 2000, above note 26, p. 9.
[63] For example [RSBC 1996] *Consumer Protection Act*. C-69; [SKU 1996] *Consumer Protection Act*, C-30.1; [RSY 1986] *Consumer Protection Act*. C. 31; [RSNWT 1988] *Consumer Protection Act*. C-17
[64] [RSPEI 1988] *Unconscionable Transactions Act*. Cap. U-2; [RSNB 1987] *Unconscionable Transactions Relief Act*. C. U; [RSNL 1990] *Unconscionable Transaction Relief Act*. U-1

Interest rates in Canada are also controlled by Federal criminal law. Section 347 of the Canadian *Criminal Code* creates a criminal interest rate of 60%. The definition of interest in Section 347 is 'the aggregate of all charges and expenses, whether in the form of a fee, fine penalty, commission or other similar charge or expense or in any other form, paid or payable for the advancing of credit'.[65]

Payday lenders would clearly be in breach of Section 347. However while there have been several prosecutions of pawnbrokers under this section there have as yet been no cases brought against payday lenders. Ramsay suggests public authorities do not actively enforce this section. Crown attorneys might also be reluctant to prosecute in cases where the amounts seem small and the perpetrator may themselves be a small business.[66]

4.3 United Kingdom

While payday lending is relatively recent in the UK there has been considerable concern over the rise of the alternative financial sector over the past 2 decades. The alternative financial sector in the UK comprises weekly collected credit companies (moneylenders), unlicensed moneylenders, pawnbrokers, mail order companies and new entrants to the UK market including payday lenders and franchise operations such as the Australian-based *Cash Converters* and *Crazy George*. There are also non-status lenders offering secured loans to those without a sufficient credit rating to obtain loans from mainstream providers.[67]

In the UK payday advances are offered by cheque cashing businesses that primarily cash third party cheques but also, for substantial fees, offer cash advances for post-dated cheques. Rollovers are also common. Available evidence would however suggest that effective Annual Percentage Interest Rates in the UK are lower than the US and Canada, with 1 study citing an example with an APR of 181.2%.[68]
Many UK cheque-cashing outlets are operated by pawnbrokers and moneylenders.[69] There are also several major franchise operations offering payday loan products in the UK. N&N Group offers customers a 'salary stretcher' service through 300 UK outlets. One US payday loan operation, Dollar Financial, has crossed the Atlantic, and offers payday loan products through the *Money Shop* franchise in 450 locations in the UK.[70]

Smaller operations include *C-4-C* (Cash for Cheque), *Xpress Cash Ltd*. and *Chequechangers*. Expansion of the industry has been rapid, and the industry representative body, The British Cheque Cashers' Association (BCCA), currently has a membership of 350 companies representing over 1000 outlets.[71]

4.3.1 Regulatory Environment (UK)

Payday advance loans in the UK are defined as extended credit and are subject to the provisions of the *Consumer Credit Act 1974*. There has been considerable criticism of this Act, primarily for its failure to protect vulnerable consumers. While the *Consumer Credit Act 1974* was intended to enhance legal redress for consumers exposed to extortionate credit bargains, in practice it has resulted in greater leniency for lenders.[72]

The main criticisms of the current legislation are:

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[65] [RS 1985] *Criminal Code* cap. C-46 s. 347(2).
[66] Ramsay 2000, above note 26, p. 31; see also Ramsay 1995, above note 26, p. 191 for discussion of legislation regulating cost of credit.
[67] Kempson & Whyley 2000, above note 35, pp. 9-12.
[68] Kempson & Whyley 2000, above note 35, p. 10; for procedure of obtaining payday advance and costs in the UK see also P. Jones 2001, *Access to Credit on a Low Income*, Co-operative Bank: UK, pp. 32-33; http://www.furnitureresourcecentre.com/frcgroup/downloadfiles/access_to_credit.pdf (accessed 25 January 2002)
[69] M. O'Hara & T.Levene 2002, 'Tempted by the pawn cocktail?', *The Guardian*, January 5, http://money.guardian.co.uk/creditanddebt/debt (accessed 25 January 2002)
[70] http://www.cheque-exchange.co.uk ; http://www.cashcentres.co.uk
[71] http://www.bcca.co.uk
[72] Kempson & Whyley 2000, above note 35, p. 43; the *Consumer Credit Act 1974* replaced earlier Moneylenders Acts which included a 48% interest rate cap.

- Few cases are brought before the courts as the onus rests with borrowers to initiate proceedings;
- The wording of the Act is imprecise and judicial decisions have been based on restrictive interpretations of its provisions; and
- The penalties of the Act are inadequate for dealing with extortionate credit bargains[73]

The need for modernisation of this legislation has been recognised by the UK Government. The Consumer Affairs Directorate of the UK Department of Trade and Industry commenced consultation in 2001 with a view to legislative reform.

Amongst the key objectives of the Directorate's consultation process were to develop a consumer credit regime that would target rogue traders and reflect market changes in consumer credit.[74]

4.4 Summary: The Growth of the Alternative Financial Sector and Payday Lending

It is clear that in the USA, Canada and the United Kingdom the previous 2 decades have witnessed rapid expansion of the alternative financial sector. Current indications suggest that this expansion will continue into the foreseeable future.

The expansion of payday lending, along with other forms of alternative credit, raises significant questions of public policy and consumer protection. The high charges associated with payday lending seem to confirm the thesis of David Caplovitz's classic text *The Poor Pay More*.[75] In modern consumer societies where credit is not a means of advancement but merely a sign of participation, those with the least resources are paying the market's highest prices.

Effective policy responses require understanding of the broader socio-economic context out of which the current alternative financial sector has emerged.

The appearance and subsequent growth of payday lending can be explained by broader socio-economic factors common across national borders. These are:

- Deregulation of the mainstream financial services and withdrawal of services from low-income consumers;
- Stagnating or declining real incomes amongst lower income earners in industrialised economies;
- Rising levels of credit use across social strata;
- Increasing levels of household debt and declining levels of savings; and
- Rising rates of personal bankruptcy

4.4.1 Financial Services

In the USA, Canada and the United Kingdom similar trends in financial services are evident over the past 2 decades. Mainstream banks have increasingly discouraged low-income consumers, both through raising basic transaction costs and by removing financial products tailored to their needs. Major financial institutions have abandoned short-term small loans.

Banks have redirected credit away from socially disadvantaged groups and towards wealthier consumers perceived to present less risk and yield higher profit margins. As Leyshon and Thrift suggest, since the debt crisis of the early 1990s 'financial capital is retreating to a middle class heartland'.[76]

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[73] Kempson & Whyley 2000, above note 35, pp. 38-44; Jones 2001, above note 68, p. 44.
[74] DTI, Consumer Affairs Directorate 2001, *Tackling Loan Sharks — And More: Consultation Document on Modernising the Consumer Credit Act 1974*, DTI: London, http://www.dti.gov.uk/CACP/ca/consultation/loanshark.htm (accessed 17 November 2001)
[75] D. Caplovitz 1967, *The Poor Pay More: Consumer Practices of Low Income Families*, Free Press: London.
[76] A. Leyshon & N. Thrift 1997, *Money/Space: Geographies of Monetary Transformation*, Routledge: London, p. 226.

The result has been larger numbers of consumers excluded from mainstream financial services and products.

4.4.2 Real Incomes and the Labour Market

Economic and political changes dating from the 1980s have created increasing inequalities in the UK and North America. While higher income earners have reaped the benefits of macroeconomic restructuring, real incomes at the lower end of income distribution have stagnated or declined.

The rise of the service economy and the decline of the occupational structure associated with Fordist mass production have also resulted in rising levels of unemployment, increased job insecurity and a rise in the level of low paying, part-time and casual employment. [77]

The barrier between a secure middle class and vulnerable consumers is also less clear, as the unpredictable consequences of economic restructuring render the control of personal finances more problematic.

The result is that increasing numbers of consumers resort to credit to maintain living standards in the face of stagnating or declining incomes, or to tide over the unpredictable shocks inherent in a 'flexible' labour market.[78] Short-term and casual employment status can also result in exclusion from mainstream credit sources requiring proof of a stable employment history.[79]

4.4.3 Rising Levels of Credit Use

In the past 2 decades there has been an unprecedented expansion both in credit provision and in the use of credit by consumers. The normalisation of credit as a tool of personal finances has significant social as well as economic ramifications.

Although the purpose of credit differs across income groups, access to credit is now essential to meaningful social participation in advanced economies. Credit is commonly regarded as a part of everyday life.

As Professor Iain Ramsay has commented,

> *…access to consumption opportunities in the consumer driven economies of the North reflects both material needs and symbolic expression of status. Exclusion from access to credit may therefore mean both economic exclusion from markets, such as housing which may be a key to social mobility, and also exclusion from a central aspect of public expression in modern society.*[80]

Consequently exclusion from credit in advanced economies represents financial *and* social deprivation.

4.4.4 Rising Levels of Household Debt

In North America and the UK there has been a sharp increase in the level of household debt over the past 2 decades. Available research in the US and Canada also suggests that those on lower and lower to middle incomes have higher debt-to-income ratios than higher income earners.[81]

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[77] Ramsay 1995, above note 26, p. 180; for US see Caskey 1991, above note 9, pp. 97-99; UK see Kempson & Whyley 2000, above note 35, pp. 73-92

[78] Ramsay 2000, above note 26, p. 3; see also FSA 2000, above note 33, p. 12; Berthoud & Kempson 1992, above note 29, p. 64.

[79] Office of Fair Trading (OFT) 1999, *Vulnerable Consumers and Financial Services: The Report of the Director General's Enquiry*, Rep No. OFT 255, OFT: London, pp. 17-16.

[80] Ramsay 1995, above note 26, p. 181.

[81] Ramsay 2000, above note 26, p. 1-2; Caskey, 1991, above note 9, pp. 99-106; Drysdale & Keest 2000, above note 22, pp. 591-593.

A linked factor is an overall decline in the ratio of savings to disposable income among consumers. Economic research confirms that the savings of lower income consumers are the most affected by this trend.[82] An increasing number of consumers therefore have no 'margin of safety' against unexpected shocks to their budget.

Such consumers may be unattractive to mainstream financial institutions who would rate them as 'high risk'. Other consumers may find themselves overcommitted and unable to access further credit through mainstream financial institutions.[83]

Therefore a large pool of consumers exists with a strong desire for credit who are not catered for by the mainstream sector.

4.4.5 Rising Rates of Personal Bankruptcy

There has been a sharp rise in the number of personal bankruptcies in North America and the UK since the 1970s. Filings for personal bankruptcy in the US increased from 200 000 in 1978 to over a million in 1996.[84]

Data for Canada and the UK exhibits a similar trend. Personal bankruptcy rates reflect a more general rise in the number of people with poor credit ratings resulting in a history of bad debt.[85]

The use of ever more refined credit risk assessment tools by mainstream financial institutions means those with blemished credit records are likely to be rejected. Consequently there is a demand for credit among people with a history of bad debt that is not being met by mainstream creditors.

These broader socio-economic factors provide explanations for the rise of the alternative financial sector, and more specifically payday lending, in North America and the UK. Each factor is also mirrored in the Australian context. The following chapter discusses these factors and their relationship to the emergence of payday lending in Australia.

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[82] K. Dynan, J Skinner & S. Zeldes 2000, 'Do the Rich Save More?', Federal Reserve Board, *Finance & Economic Discussion Series No. 52*, December http://www.federalreserve.gov/pubs/feds (accessed 22 January 2002)
[83] Ramsay 2000, above note 26, p. 2.
[84] P. Bishop 1998, 'A Time Series Model of the U.S. Personal Bankruptcy Rate', *Bank Trends*, 98/01, February, p. 1 http://www.fdic.gov/bank/analytical/bank/bt_9801.pdf (accessed 22 January 2002); see also D. Ellis 1998, 'The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge Offs and the Personal Bankruptcy Rate', *Bank Trends*, 98/05 http://www.fdic.gov/bank/analytical/bank/bt_9805.pdf (accessed 22 January 2002)
[85] Ramsay 2000, above note 26, p. 3; Kempson & Whyley 2000, above note 35, p. 28.

5. Payday Lending in Australia

Payday lending is a recent arrival on the Australian financial scene. Payday loans are short-term high interest loans, usually unsecured, and for amounts under $1000. Loans are for periods of less than 62 days.

Payday loans in Australia do not generally involve post-dated personal cheques, as is the case in the UK and North America. In Australia payday loans are repaid either through a direct debit from the borrower's bank account or, less frequently, by cash payments.

Until recently payday lending was unregulated as section 7(2) of the Uniform Consumer Credit Code exempted loans under 62 days. Recent Queensland legislation has however brought payday lending within the provisions of the Uniform Consumer Credit Code.[86]

In its brief history payday lending has attracted considerable controversy. The subject is one of great interest to the print and broadcast media. Consumer advocates and politicians have decried payday lenders as loan sharks. Concern has also been expressed by government regulatory agencies and the Uniform Consumer Credit Code Management Committee. Protests against the industry, involving some protestors dressed in shark suits, have occurred in Sydney and Melbourne.[87]

Consumer advocates argue payday lending exploits vulnerable consumers by charging unconscionably high rates of interest and encouraging spirals of consumer debt. They argue payday lending deliberately targets vulnerable consumers through advertising and locating shopfronts in lower socio-economic locations.[88]

The major criticisms of payday lending are the following:

- Payday lenders charge unconscionably high rates with effective interest charges as high as 1300% per annum;
- Payday lenders target vulnerable consumers;
- Payday loans lead vulnerable consumers into debt spirals through 'roll-over' and 'back-to-back' loans; and
- Lenders use direct debit as a form of payment guarantee, thus giving them first take at the income of those who may be in financial difficulty and exposing them to high dishonour fees from banks[89]

The payday lending industry argues it fills a void in the marketplace by offering short-term credit to those for whom it would otherwise be unavailable. It maintains high charges are justified by the risks involved in the short-term loan market, and by the administrative overheads involved in providing short-term credit. Furthermore the industry argues consumers are not exploited but use pay day lenders' services out of choice.[90]

This chapter examines the following aspects of payday lending in Australia:

- The Australian payday lending industry and market size;
- The socio-economic context of payday lending; and
- The Australian regulatory environment

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[86] *Consumer Credit (Queensland) Amendment Act 2001*

[87] L. McIlveen, L. Milligan & G. Leech 2001, 'Crackdown on pay-day loan sharks', *The Australian*, 4 April, p. 4.

[88] See for example L. Petschler, 'How to borrow @ 972% p.a.', *Consuming Interest*, Summer 2001, pp. 6-9.

[89] C. Field 2002, 'The Sharks are circling — A report on payday lending', 30 *Australian Business Law Review* 148 at p.149.

[90] P. Syrvet 2001, 'The Quick and the Debt', *The Bulletin*, February 6, p. 31; Australian Financial Services Association (AFSA) 2001, *Submission to Queensland Minister of Fair Trading*, September, pp. 18-20.

5.1 Payday Lending: Industry and Market Size

The first payday lender began operating in Australia in December 1998 in Queensland. There are no precise figures available on the current size of the payday lending industry. However a report prepared by the Queensland Office of Fair Trading in August 2000 estimated 82 payday lending businesses were operating throughout Australia located in all States except Tasmania.

The highest number of outlets were located in Queensland where the industry began, followed by New South Wales, Western Australia and Victoria. At the time of the Queensland report one operator also had an outlet in New Zealand.[91]

Payday lending businesses currently include *AMX*, *Cash Stop*, *Cash Converters*, *Money Centre*, *Financial Express* and *Money Plus*. There are also individual businesses in the market offering payday loans. There is considerable volatility in the market and name changes, closures and the appearance of new operations are a feature of the industry.

A recent development has been the appearance of on-line payday lending through the Queensland registered company *RTO Payday Advance*. *RTO* offers loan approval within 24 hours and deposits funds electronically into the borrower's bank account. The loan repayment is then direct debited from the borrower's bank account.[92]

The industry in Australia remains small, and in 2000 the total market for payday loans was thought to be 2000 payday loans per month at most. However current figures from Victoria suggest the national market is now considerably larger than this. A conservative estimate would be that there are 12 800 payday loans every month across Australia, and 153 600 annually.[93]

Industry estimates in early 2001 suggested the national market for payday lending to be about $200 million annually.

The customer base nationally is estimated to be between 100 000 and 150 000.[94] The Queensland report anticipated rapid expansion of the industry, suggesting there could be as many as ten times the current number of outlets in Australia within the next five years.[95]

5.2 Socio-economic context

Representatives from the payday lending industry frequently point out that there is a demand for the financial products they offer.[96] The rapid growth of the industry in Australia would seem to confirm that there is a significant demand for short-term credit for relatively small amounts.

Whether payday lending represents an appropriate response to this demand is another matter entirely. Nevertheless any discussion of policy with regard to payday lending and short-term credit requires an understanding of the broader socio-economic factors driving consumer demand.

Socio-economic factors influencing the demand for short-term credit in Australia are similar to those discussed for North America and the UK in Chapter 4. These include:

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[91] Queensland Office of Fair Trading 2000, above note 42, p. 5.
[92] http://www.rtopaydayadvance.com.au
[93] Estimate provided by Mr Rob Bryant, Managing Director, *Money Plus*, 30 January 2002. This estimate takes the estimate for Victoria of 800 loans statewide per week and assumes that NSW and ACT combined, Queensland and WA would have a similar number of transactions.
[94] Syrvet 2001, above note 90, p. 30; AFSA 2001, above note 90, p. 5.
[95] Queensland Office of Fair Trading 2000, above note 42, p.5.
[96] Public Debate 2001, 'Payday Loans: Should they be outlawed?', February 11 http://www.publicdebate.com.au/is/773/ see comments by Peter Llewellyn, AMX.

- Deregulation of the banking sector and the withdrawal of services from low income consumers;
- Declining or stagnating real incomes amongst lower income groups;
- Rising use of credit across social strata;
- Rising levels of household debt and decreased levels of savings; and
- Increasing rates of personal bankruptcy and individuals with poor credit ratings

5.2.1 Banking

Deregulation of the Australian banking sector since the 1980s has had negative consequences for low-income consumers. Many banks now pursue the most profitable niche markets, giving less emphasis to sectors thought to yield lower returns. While wealthy customers receive fee waivers and other discount incentives those with smaller accounts continue to face rising fees and account keeping costs.[97]

Rising costs for basic accounts have been accompanied by the withdrawal of financial products tailored to the needs of low-income consumers. Although seldom stated publicly, this often forms part of bank policy to discourage consumers perceived to yield low returns and present high risk.[98]

Personal loans of sums under $1000 are such a financial product. Banks generally do not make personal loans under $2000 and for periods of less than a year, preferring instead to direct such loans to credit cards.[99] This disadvantages many low-income consumers who either do not qualify for, or who choose to avoid, credit cards.

Arguments from the banking sector that such loans are too expensive to administer are undermined by the very appearance and expansion of payday lending in Australia.

The result for low-income consumers requiring short-term credit is clear. Banks have abandoned this sector of the market, leaving consumers with a severely limited range of high cost options.

5.2.2 Increasing inequality and declining incomes

A significant body of research has now amassed demonstrating that Australia is an increasingly unequal society. Using measures such as income distribution, asset wealth, and access to goods and services, academic studies provide empirical evidence of the widening gulf between rich and poor. In doing so they confirm what many in the welfare and community sectors have sensed through increasing demand placed on their services.[100]

Economic restructuring has also transformed the Australian labour market. The most remarkable shift has been the erosion of full-time permanent employment and a corresponding rise in casual and part-time employment. In 1998 27% of the Australian workforce was employed on a casual basis.[101]

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[97] NSW Department of Fair Trading 2000, *Minimum Banking Services Discussion Paper*, NSW DFT, p. 4.

[98] C. Connolly & K. Hajaj 2000, *Financial Services and Social Exclusion*, Financial Services Consumer Policy Centre, University of New South Wales: Sydney, p. 12.

[99] Cheah & Singh 1993, above note 36, pp. 2-3.

[100] See for example K. Norris & B. McLean 1999, 'Changes in Earnings Inequality, 1975 to 1998', *Australian Bulletin of Labour*, 25/1, March, pp. 22-31; H. Baekgaard 1998, 'The Distribution of Household Wealth in Australia: 1986 and 1993', National Centre for Social and Economic Modelling, *Discussion Paper No. 34*, Canberra; R. Fincher & J. Nieuwenhuysen (eds.) 1998, *Poverty Then and Now*, Melbourne University Press: Melbourne; S. Richardson & A. Harding 1998, 'Low Wages and the distribution of family income', National Centre for Social and Economic Modelling, *Discussion Paper No. 33*.

[101] I. Watson & J. Buchanan 2001, 'Beyond impoverished visions of the labour market', in R. Fincher & P. Saunders (eds.), *Creating Unequal Futures: Rethinking Poverty, Inequality and Disadvantage*, Allen & Unwin: Sydney, p. 198.

The industrial and occupational structure of the Australian labour market has also undergone considerable change. The better-paid manufacturing jobs have declined while low paid employment in the service sector has increased.

The result of labour market deregulation for many has been increased economic insecurity and declining real incomes. For low-paid workers it is a considerable struggle to stretch thin pay packets from week to week.[102] It is now quite possible to be in full-time full year employment and live in poverty, and existing research indicates the 'working poor' are a real and growing presence in Australian society.[103] As Watson & Buchanan note:

> *…disadvantage percolates across the entire labour force. It clings most tenaciously to the long-term unemployed, it dogs the footsteps of the precariously employed, and it furrows the brow of the mature age under-employed.*[104]

Unemployment, underemployment, casualisation and declining real wages have significant implications upon consumer demand for, and access to, short-term credit. There are 4 major implications that should be noted:

1. Low-income consumers will increasingly resort to credit in order to maintain living standards in the face of stagnating or declining real incomes;
2. Low income reduces the capacity of consumers to amass savings, thereby making them vulnerable to unexpected financial shocks;
3. Similarly, consumers with periodic or unpredictable incomes will often seek short-term credit to 'smooth over' fluctuations in their finances; and
4. Consumers in short-term and casual employment will have limited access to mainstream credit often requiring proof of a stable employment history.[105]

5.2.3 Rising demand for credit

There has been a considerable expansion in the use and availability of credit in Australia since the post war period. Australia's post-war economic boom was partially fuelled by the increased availability and use of consumer credit, facilitating the purchase of mass consumer goods and services.[106]

By the early 1970s Australians had become the third largest users of credit in the world. Lending to households, excluding housing finance, grew at an average of 14% per annum during the 1980s. The Australian 'borrowing binge' escalated during the 1990s and continues into the present.[107]

The use of credit in Australia has expanded to such an extent that access to credit is crucial to an individual's ability to participate fully in society. However it is important to note that credit fulfils different purposes, and has different social meanings, for different income groups. As Berthoud & Kempson noted in their study of credit and debt in the UK.

> *Poorer families, on the whole, use credit to ease financial difficulties; those who are better-off take on credit commitments to finance a consumer life-style.*[108]

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[102] ACIRRT 1999, *Australia at Work: Just Managing?*, Prentice Hall: Sydney, pp. 94-100.
[103] T. Eardley 1998, 'Working but Poor? Low Pay and Poverty in Australia', *SPRC Discussion Paper No. 91*, Social Policy Research Centre: UNSW, November http://www.sprc.unsw.edu.au (accessed 30 January 2002)
[104] Watson & Buchanan 2001, above note 101, pp. 205-206.
[105] Ramsay 2000, above note 26, p. 3; FSA 2000, above note 33, p. 12.
[106] G. Whitewall 1989, *Making the Market: The Rise of Consumer Society*, McPhee Gribble: Melbourne, p. 16.
[107] B. Hahn 1997, *Just Credit: Should Access to Credit be a Citizenship Right?*, Good Shepherd Youth & Family Service: Melbourne, p. 2; On the 1990s, see G. Lekakis 2000, 'The Money Trap', *Australian Financial Review*, 22 December, p. 25.
[108] R. Berthoud & E. Kempson 1992, above note 29, p. 64.

Current trends suggest that the demand for consumer credit in Australia will continue to increase. This is particularly so for low-income consumers, who look to short-term credit to stave-off the economic hardships brought about by growing inequality and the uncertainties of a 'flexible' labour market.

Despite the expansion of credit provision in the 1970s and 1980s, low income consumers still have only a limited number of high cost options in accessing credit.[109] The rise of the payday lending industry has been possible due to failure of financial markets to supply appropriate credit to a growing demographic of consumers.

5.2.4 Increasing Household Debt

The level of household debt in Australia has been rising sharply since the 1970s. Over the 1990s household debt almost doubled to about 60% of GDP.[110] Household debt has increased from about 50% of household disposable income at the start of the 1990s to 90% in 1998.[111] Personal indebtedness follows a similar upward trend.

Rising personal and household debt have been accompanied by a steep decline in household savings. Australia's household savings rate has declined from being one of the highest in the OECD to being amongst the lowest.[112] The trend towards declining savings is likely to be particularly marked for low-income consumers, who already have a reduced capacity to accumulate savings.[113]

Higher levels of indebtedness and reduced savings make low-income consumers particularly vulnerable to financial shocks. Without any 'margin of safety' unanticipated expenses can easily translate into financial crises.

There are 3 significant implications of the high debt-low savings environment upon the demand for short-term credit:

1. Increasing demand from low-income consumers for short-term credit to smooth over fluctuations in circumstances, and/or, service existing debts;
2. Less likelihood of low-income consumers obtaining credit from mainstream financial institutions due to existing debt and lack of savings record; and
3. Lower-middle and middle-income consumers already overcommitted to mainstream financial institutions unable to access further credit in emergency situations.

5.2.5 Rising rates of personal bankruptcy

The rate of consumer bankruptcy has risen dramatically in Australia since the 1970s. Bankruptcies have tripled in a decade and increased by 21% in 2001.[114] In the mid-1970s the number of business and non-business (or consumer) bankruptcies were approximately equal. In recent years the number of business

[109] B. Hahn 1999, 'No Interest Loan Schemes: What are they?' *paper delivered to NCOSS No Interest Loans Schemes Conference*, 30 June.
[110] P. Cleary 2001, 'Household Debt through the Roof', *Australian Financial Review*, 30 August, p. 7.
[111] Reserve Bank of Australia 1999, 'Consumer Credit and Household Finances', *RBA Bulletin*, July, p. 15.
[112] T. Colebatch 2001, 'Family savings in crisis', *Age*, 20 August, p. 1; On general trends in household savings see M. Edey & L. Gower 2000, 'National Savings: Trends and Policy', *Paper delivered to 2000 RBA Conference: The Australian Economy in the 1990s, 24-25 July* http://www.rba.gov.au/publicationsandresearch/conferences/2000/index.html
[113] J. Loundes 1999, 'Household Saving Behaviour in Australia', *Melbourne Institute Working Paper No. 17/99*, Melbourne Institute of Applied Economic and Social Research, p. 15.
[114] AFR 2002, 'Bankruptcy reform deserves due credit', *Australian Financial Review*, 11 January, p. 52.

bankruptcies has remained relatively steady while the number of consumer bankruptcies has increased significantly. In the 1997/1998 financial year consumer bankruptcies accounted for 80.1% of the total. [115]

Rising rates of consumer bankruptcy reflect an overall rise in the number of bad debts in Australia. One indication is the expansion and consolidation of the debt collection industry in Australia, which confidently predicts a steady growth in business.[116]

Popular images of the bankrupt as a cavalier entrepreneur of the Alan Bond or Christopher Skase mould are a long distance from reality. A study of consumer bankrupts in Melbourne revealed the average consumer bankrupt was likely to be unemployed and living in rented accommodation. They would not have completed secondary school and, if employed, it would be in the clerical, sales, construction or transport industries or a blue-collar occupation.[117]

The Melbourne study revealed most consumer bankrupts to be the victims of changed circumstances including unemployment, ill-health and other unexpected shocks to income.[118] In the 2000/2001 financial year 'unemployment' was stated as the cause in 40% of consumer bankruptcies.[119] Generally consumer bankruptcy results from fluctuations in a 'flexible' labour market and inadequate income, not from recklessness or a desire to evade creditors.

The net result of these trends in bankruptcy and bad debt is an increasing number of Australian consumers with poor credit ratings. These consumers are excluded from mainstream financial services, and are therefore compelled to seek out the few high-cost credit providers in the marketplace. Payday lenders specifically target these vulnerable consumers.

5.3 Australian Regulatory Environment[120]

Until very recently, payday lenders were able to escape regulation by the national instrument that governs consumer credit in Australia – The Uniform Consumer Credit Code (the Code). The Code commenced in all Australian jurisdictions on 1 November 1996, after a number of years' discussion between governments, business and consumer organisations. The Code replaced various State and Territory Credit Acts enacted in the 1980s, and was intended to create a uniform legislative scheme underpinned by the Australian Uniform Credit Laws Agreement 1993.[121]

Certain credit transactions are, however, exempt from the operation of the Code. One of these exemptions is where the provision of credit is for 62 days or less. The exemption was intended to 'allow banks to provide short-term bridging finance and for trade credit arrangements[122]'. Thus payday lenders have been able to operate outside the jurisdiction of the Code by providing credit for less than 62 days and the exemption has been fully utilised by payday lenders who generally provide credit for 14 and 28 days.

Lobbying efforts by the national consumer movement have resulted in a recent and important amendment to the Code. The Consumer Credit (Queensland) Amendment Act 2001 (the Act) received assent on 16 August

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[115] R. Mason 1999, 'Consumer Bankruptcies: An Australian Perspective', *Osgoode Hall Law Journal*, 37/1-2, pp.457-458.
[116] T. Condon 2002, 'The debt collectors begin to pay off', *Business Review Weekly*, p. 35.
[117] M. Ryan 1993, above note 117, 'Consumer Bankrupts in Melbourne', *Australian Journal of Social Issues*, 28/1, February, p. 37.
[118] Ryan 1993, above note 117, p. 45.
[119] Inspector-General In Bankruptcy 2001, *Annual Report by the Inspector-General in Bankruptcy on the Operation of the Bankruptcy Act 2000-2001*, Insolvency and Trustee Service Australia: Canberra, p. 15 http://www.itsa.gov.au (accessed 31 January 2002)
[120] The information contained in this section of the report is primarily taken from Field 2002, above note 44, and Field 2002, above note 89.
[121] The Code replaced Lending of Money Acts in Tasmania and the Northern Territory. South Australia preceded other States by enacting the *Consumer Credit Act 1972* (SA)
[122] Field 2002, above note 44.

2001 and commenced operation on 10 December 2001. The Act amends section 7(1) of the Code such that for a credit contract to be exempt from the operation of the Code:

- The contract must not exceed 62 days;
- Any fee or charge must be no more than 5% of the amount of credit; and
- Any interest rate must not exceed 24% per annum

Under the uniform arrangements of the Code, these changes are implemented either automatically or through separate State legislation.

Amendments to the Code will also require payday lenders to disclose fees and charges payable, provide consumers with a copy of their credit contract and provide information concerning available options to consumers who cannot repay loans. Payday lenders are effectively also required to make an assessment of a consumer's capacity to pay a loan. There are also penalties imposed for credit providers who breach these provisions and in some instances, compensation payable to consumers in the event of a breach. Great emphasis has therefore been placed on disclosure or 'truth in lending' as such legislation arguably makes the debtor more aware of the nature of the transaction and the rights and obligations attaching to the transaction.[123] There is significant argument, however, as to whether disclosure actually impacts upon consumer behaviour, particularly in the case of low-income and vulnerable consumers.[124]

The Consumer Credit Amendment Regulations (No 1) 2001 have introduced 2 additional changes. The first change is that "approved deposit taking institutions" are exempt from the new section 7(1) of the Code. This change recognises that mainstream financial service providers are not intended to be caught by section 7(1) of the Code. The second change effectively lowers from $200 to $50 the amount of the credit contract where the Code does not apply and this change recognises that payday lenders typically lend amounts which are less than $200, and almost always over $50.

There are 3 significant matters, however, which are not addressed by the Act:

- The amendments do not require payday lenders to disclose the cost of credit as an annual percentage interest rate;

- The amendments do not implement a national interest rate cap of 48%. The 48% interest rate cap currently only applies in New South Wales, Victoria and the Australian Capital Territory; and

- The amendments do not explicitly specify whether the Code interest rate cap (where it applies) includes all relevant fees payday lenders charge, so that the true cost of credit does not exceed the cap.

These matters have been addressed in New South Wales by the Consumer Credit (New South Wales) Amendment (Payday lenders) Act 2001. This legislation caps the annual percentage interest rate on short term loans at 48% and specifies that all charges and fees must be included as part of the annual interest rate.[125]

Tasmania has also gone significantly further than the Queensland template legislation effectively banning payday lending with sunset legislation while awaiting legislative developments in other jurisdictions.

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[123] J. Goldring, L. Maher, J. McKeough & G. Pearson 1998, *Consumer Protection Law*, Federation Press: Sydney, p. 308.
[124] Ramsey, 2000, above note 26, p.30.
[125] *Consumer Credit (New South Wales) Special Provisions Amendment (Payday Lenders) Regulation 2001*, Clause 7A (1). *The Consumer Credit (Western Australia) Amendment Act 2001* also has a power that will permit the making of regulations to require credit fees and charges to be included in the calculation of the Annual Percentage Rate.

5.4 Summary

In Australia, payday loans are short-term high interest loans, usually unsecured, and for amounts under $1000. Recent industry estimates have suggested the national market for payday lending is in the vicinity of $200 million annually.

The rise of the payday lending industry can in part be attributed to several phenomena including the deregulation of the banking industry and the rising cost of credit, declining real incomes amongst lower income groups, rising levels of household debt and decreased levels of savings, and increasing rates of personal bankruptcy.

Australia is currently experiencing a somewhat stronger regulatory response to payday lending over time. Until recently payday lending was unregulated as section 7(2) of the Uniform Consumer Credit Code exempted loans under 62 days. Recent Queensland legislation has however brought payday lending within the provisions of the Uniform Consumer Credit Code, with some states introducing more stringent controls on payday lending than others. Current lobbying efforts have been directed towards enforcing a maximum overall cost of credit of 48%, together with the introduction of non-exploitative lending to meet the demand for short term loans.

6. The payday lending industry in Victoria

The first payday lending business in Victoria, *ChequEXchange* Northcote, began operation in May 2000. Further *ChequEXchange* branches in Dandenong and Frankston opened in the same month.[126] The number of payday lending businesses in Victoria has since fluctuated, reaching a peak in mid-2001 when approximately 25 businesses offered payday loans.

Payday loan operations generally offer a range of financial services in addition to short-term loans, including cheque cashing services and longer-term loans. However results from the Consumer Law Centre Victoria street survey indicate the vast majority of their business is in short-term loans.

Eighty-three consumers were approached for the street survey. Seventy-three (88%) consumers were visiting a payday lender to repay or obtain a payday loan. Only 6 (7%) were using cheque cashing services.[127] No consumers reported seeking longer-term loans or using other services.

At present there are 16 payday lending businesses in Victoria. Of these, 14 are located in Greater Melbourne and 2 in Geelong (See Table 1). These include the franchise operations of *Money Plus* and *Cash Stop Financial Services*, one *Australian Money Exchange (AMX)* one *Blue Star Capital* and several owner-operator businesses trading under various monikers and formerly part of the now defunct *ChequEXchange* franchise.

Most Victorian payday lenders, with the exception of *Money Plus* outlets, are members of the Australian Financial Services Association Ltd. (AFSA), an industry advocacy group.[128]

There are an estimated 750-800 payday loans transacted across Victoria every week. The average loan size is $258.60, which would translate to over $10 million in payday loan transactions statewide per year.[129]

The information provided in this section is current as at February 2002.

6.1 Lenders

The following is a brief outline of payday lending businesses that have operated, or are currently operating, in Victoria. Any investigation of these businesses makes clear that there is considerable volatility in the payday loan market.

Another recent trend has been towards the diversification of financial products offered. Most payday lenders are promoting home, car and other longer-term loans and attempting to move into the section of the market currently occupied by providers such as *City Finance* and *GE Finance*.[130]

It also appears that the rapid expansion of the industry evident between mid-2000 and mid-2001 has abated. Product diversification and a reduction in the number of operations may result from regulatory uncertainty in the marketplace. There is also some suggestion that the initial estimates of the potential client base were over inflated.

[126] Advertisement, *Northcote Leader*, 24 May 2000, p. 11.
[127] This is acknowledged by payday lenders. Mr John McKenna, Director, *ChequEXchange Frankston* estimates cheque cashing accounts for only 10%-15% of that outlet's overall business (Telephone communication 4 February 2002).
[128] Telephone communication with Mr John McKenna, Director, *ChequEXchange Frankston*, 4 February 2002.
[129] Telephone communication with Mr Rob Bryant, *Money Plus*, 30 January 2002.
[130] *City Finance* markets very aggressively to low-income consumers through the suburban press with the slogan 'pensioners and single parents welcome, loans from $300 to $2000'. See for example *Moreland Leader* 2001, October.

6.1.1 Australian Money Exchange (AMX)

Outlets of the Queensland-based franchise *Australian Money Exchange (AMX)* appeared in Melbourne shortly after the establishment of *CashEXchange* branches. Businesses were located in Dandenong, Frankston, Geelong, Springvale, Sunshine and Werribee.

AMX growth plans envisaged expansion across Australia and internationally. There were also plans for an *AMX* card and a network of automated teller machines (ATMs) to provide instant loans to approved customers.[131]

The franchise was to be floated on the Australian Stock Exchange but ran into difficulties. The Directors of *AMX* formed *Blue Star Capital* and most *AMX* operations in Melbourne switched to the new venture.

One payday lending business in Brunswick continues to trade under the *AMX* name.

6.1.2 Blue Star Capital

Blue Star Capital formally traded as *Australian Money Exchange (AMX)*. The company was a franchise operation based on Queensland's Gold Coast with 16 retail outlets in Queensland, New South Wales and Victoria. *Blue Star Capital* offered payday loans along with a range of other financial products to consumers including longer-term personal loans, car loans and home loans. It also advertised a range of business financial products including payroll services and business insurance.

The rebadging of *AMX* as *Blue Star Capital* was clearly an attempt to improve the image of payday lending. *Blue Star* described itself as a 'specialist financial services provider' and company literature stressed 'excellent self-regulation policies, compliance programs and procedure manuals' adding that the company was 'fully credit code compliant'. The quest for legitimacy in the financial services marketplace was further emphasised by the description of outlets as 'mini banks'.[132]

The company had 8 shopfront operations in Victoria. Outlets were located in Box Hill, Dandenong, Frankston, Geelong, Moonee Ponds, Springvale, Sunshine and Werribee.

Blue Star Capital ceased trading in Victoria in mid-October 2001, and has subsequently become a wholesale supplier of financial products offered through other payday loan operations.[133] Shares in *Blue Star Capital* are currently being marketed through LM Investment Management Ltd and the venture appears to be planning to list on the ASX.[134]

Four of its former shopfront locations have been taken over by the Sydney-based Cash Stop Financial Services. One Moonee Ponds payday lender continues to trade under the *Blue Star Capital* name.

6.1.3 Cash Converters

The Australian-based international franchise operation *Cash Converters* has 21 retail outlets in Victoria. *Cash Converters* is a publicly listed company on the Australian Stock Exchange.[135] A payday loan product marketed by First Capital Alliance and available through *Cash Converters* outlets was trialed in several Melbourne stores in 2001.

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[131] http://www.australianmoneyexchange.com (accessed 20 December 2001)
[132] Blue Star Capital Brochure 2001, April.
[133] Telephone communication with John McKenna, Director, *ChequEXchange Frankston*, 4 February 2002.
[134] http://www.lmim.com.au/investment_products/secondsales.htm (accessed 8 February 2002)
[135] http://www.cashconverters.com

Telephone inquiries revealed *Cash Converters* outlets no longer offer payday loans and the franchise appears to have withdrawn from the market.

6.1.4 Cash Stop Financial Services

Cash Stop Financial Services established its first retail outlet in Petersham, Sydney in April 2000. The company originates from Canada. Company advertising states it offers an alternative to 'more traditional sources that are generally geared to high value longer-term lending often taking several days to approve'.

Cash Stop Financial Services offers a range of financial products including cheque cashing, payday advance, bond advance, international money transfers and money orders. The company has 10 outlets in Sydney.

Prior to October 2001 it had only 1 Victorian outlet in Geelong. However Cash Stop has recently expanded by taking over the former Blue Star Capital outlets. There are now 5 *Cash Stop Financial Services* outlets in Victoria located in Geelong, Werribee, Sunshine, Dandenong and Springvale.[136]

6.1.5 ChequEXchange

The *ChequEXchange* franchise was the first payday lending business to establish retail operations in Victoria. Several former *ChequEXchange* outlets, including Northcote and Geelong, later became part of a new payday lending venture *Money Plus*.

ChequEXchange went into liquidation in December 2001.

Former *ChequEXchange* outlets, including stores in Croydon, Collingwood, Huntingdale and Frankston, continue as owner-operator enterprises trading under new business names (see 6.1.7).

6.1.6 Money Plus

Money Plus, a Victorian based franchise operation, currently has 5 shopfront outlets in Dandenong, Geelong, Glenroy, Greensborough and Northcote. Loan conditions and charges, shop fit out and advertising are uniform across outlets although individual operators are relatively autonomous.

The company has modest expansion plans, and Managing Director Rob Bryant suggest a further 10 shopfront lenders over the next 5 years.[137]

6.1.7 Sole Shopfront Payday Lenders

There are currently 4 owner-operator payday loan businesses in Victoria trading under individual business names. These include *The Money Tree*, *Money Centre Croydon*, *Cash Loans*Cheques Cashed** and *ChequEXchange Frankston*.[138]

Several smaller operators such as *Reservoir Small Loans* and a Victorian-based online lender have ceased trading.

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[136] http://www.cashstop.com.au

[137] Telephone communication with Mr Rob Bryant, Money Plus, 30 January 2002.

[138] *ChequEXchange Frankston* is currently in the process of renaming. Telephone Communication with John McKenna, Director, *ChequEXchange Frankston*, 4 February 2002.

Table 1: Payday Lenders trading in Victoria as at 1 February 2002

BUSINESS NAME	LOCATION
Australian Money Exchange (AMX)	BRUNSWICK
Blue Star Capital	MOONEE PONDS
Cash Stop Financial Services	GEELONG
Cash Stop Financial Services	DANDENONG
Cash Stop Financial Services	SPRINGVALE
Cash Stop Financial Services	SUNSHINE
Cash Stop Financial Services	WERRIBEE
*Cash Loans*Cheques Cashed**	COLLINGWOOD
ChequEXchange Frankston	FRANKSTON
*Money Centre Croydon**	CROYDON
Money Plus	DANDENONG
Money Plus	GEELONG
Money Plus	GLENROY
Money Plus	GREENSBOROUGH
Money Plus	NORTHCOTE
*The Money Tree**	Huntingdale

* Formerly *ChequEXchange*

6.2 Loan Conditions and Charges

A survey was conducted of 18 payday lending businesses in early November 2001. **Table 2** displays the results of this survey.

Table 2: Loan Conditions & Charges on $200/14 day loan — Payday lenders Victoria 2001

LENDER	ID REQUIRED	MINIMUM INCOME	CENTRELINK PAYMENTS ACCEPTED	FEES & CHARGES	ANNUAL PERCENTAGE INTEREST RATE (APR)	PAYMENT METHOD
AMX Brunswick	Not disclosed	No minimum	Yes	Membership fee $25.00 Loan charge $44.00 Total= $269.00	897% pa	Cash or Direct Debit
Blue Star Capital	100 points Photo ID required	No minimum Will lend 30% after tax income	No*	Membership fee $25.00 Loan charge $44.00 Total= $269.00	897%pa	Cash or Direct Debit
Cash Stop Financial Services Geelong	-2mths bank statements -100 pts ID -bill	$300 per week Will lend 30% after tax income	Yes Provided reach $300 per week	'Flat fee' $45.00 Total= $245.00	585% pa	Direct Debit
*ChequEXchange Collingwood***	-3 months bank statements -payslips -photo ID -Centrelink statement of benefits	$500 per fortnight	Yes	Administration fee $5.00 Loan charge $48.90 Total= $253.90	699% pa	Direct Debit
ChequEXchange Croydon†	-3mths bank statements -Telephone bill -Photo ID	$1500 per month	Yes Provided reach $1500 per month	Loan charge $50.00 Total= $250.00	650% pa	Direct Debit
ChequEXchange Frankston	-3mths bank statements -payslips -100 pts of ID -rent receipts -details of relatives not in same residence	$700 per fortnight	Yes	Administration Fee $5.00 Loan charge $48.90 Total= $253.90	699% pa	Cash or Direct Debit
ChequEXchange Oakleigh‡	-3mths bank statements -Telephone bill -Photo ID	$250 per week.	Yes	Loan charge $48.00 Total= $248.00	624% pa	Direct Debit
Money Plus (Dandenong)	-3mths bank statements -100 pts ID -proof of address -2/3 utility bills	$250 per week	Yes	Loan charge $48.00 Total= $248.00	624% pa	Direct Debit
Money Plus (Geelong)	-3mths bank statements -100 pts ID -proof of address -payslips	$800 per month	Yes	Not disclosed	NA	Direct Debit
Money Plus (Greensborough)	-3mths bank statements -2 recent payslips -utilities bill	$1000 per month	Yes	Loan charge $53.90 Total= $253.90	699% pa	Direct Debit
Money Plus (Glenroy)	-3mths bank statements -100 pts ID -2 utility bills	No minimum	No***	'Service Fee' $53.90 Total= $253.90	699% pa	Direct Debit
Money Plus (Northcote)	-100 pts ID -2 payslips -utilities bill	$250 per week	Yes	Not disclosed	NA	Direct Debit

*Blue Star Capital branches were instructed in August 2001 to discontinue lending to Centrelink recipients. However Springvale & Moonee Ponds outlets continued lending to Centrelink recipients after this date.

**Now trading as *Cash Loans*Cheques Cashed*

† Now trading as *Money Centre Croydon*

‡ Now trading as *The Money Tree*

***The street survey found Glenroy Money Plus was lending to Centrelink recipients.

Businesses were asked the charges and conditions attached to a $200 loan taken out over 14 days. They were additionally asked what identification was to be provided, level of income required, whether a Centrelink payment was acceptable and whether payment was to be made by direct debit or in cash.

Information was generally freely disclosed, although several lenders would not discuss what arrangements could be made if there was difficulty in making a payment until such situation arose. Two *Money Plus* outlets (Geelong and Northcote) declined to give the cost of the loan over the telephone.

Some general observations may be made on the results of the telephone survey displayed in **Table 2**.

- Annualised percentage interest rates on a $200 loan taken out over 14 days ranged between 585% per annum and 897% per annum;
- Identification requirements are reasonably uniform across the industry;
- Direct debit is the preferred payment across the industry although some lenders do permit cash payments; and
- There is considerable variation in the minimum level of income required to obtain a loan.

6.2.1 Charges

The annual percentage interest rate on loans in Victoria varied between 288% per annum and 2158% per annum.[139] More usual interest charges are around 500-700% per annum.

There is a variety of terminology engaged by payday lenders to describe the interest charges on payday loans. Commonly the amount repayable is described as a 'fee', primarily to avoid the Uniform Consumer Credit Code and the Victorian 48% interest rate cap.

AMX and *Blue Star Capital Ltd*. also have a 'membership fee' of $25 applicable to first loans. This explicitly encourages repeat borrowing as consumers are 'members' for 12 months and interest charges on subsequent loans are marginally less than those of other lenders.

Former *ChequEXchange* branches and *Money Plus* generally include a $5 'service and administration fee' on top of the basic loan charge. *Cash Stop Financial Services* has an inclusive 'flat fee'.

Further innovations in the terminology, calculation and processing of loans can be expected as new regulations come into force. There is already evidence that something along the North American deferred presentment transaction model involving personal cheques is emerging in Victoria.

Professor Iain Ramsay has noted that a characteristic of the alternative financial sector is the attempt to continuously structure and restructure loans in order to avoid regulation.[140] This is also the case in Australia, and it is highly probable that the industry in Victoria will continue to restructure loans in order to evade regulation.

6.2.2 Minimum income requirements

An important point to note is that loan conditions and procedures have been subject to rapid and frequent change across the industry. Minimum income levels to obtain loans are relatively new to the industry, and generally do not apply to existing customers.

Blue Star Capital outlets received notice from Head Office in August 2001 that loan applicants whose only income was from Centrelink payments were no longer to be approved. This directive did not apply to

[139] 288% pa = $250 over 1 month with a repayment of $311; 2158% =$50 over 2 weeks with a repayment of $91.50 (documentation held by Consumer Law Centre Victoria Ltd.)
[140] Ramsay 2000, above note 26, p. 28.

existing customers, and applicants combining Centrelink payments with part-time or casual employment were still eligible. [141]

Representatives from the industry claim as many of 30% of loan applications are rejected. While this figure cannot be confirmed it is clear that not everyone qualifies for a payday loan. Several consumers who participated in in-depth interviews had been rejected by 1 lender but managed to obtain a loan from another.[142]

Lending criteria were considerably less stringent when the industry first appeared in Victoria. One operator suggests minimum criteria have become common because borrowers with very low-incomes were found to be extremely high risk.[143] There is currently only 1 lender in Victoria who will lend to people receiving only the basic Newstart Allowance.

Assessment and approval are based primarily upon income. Given that loans are approved in under 1 hour, it is apparent that assessments of consumers' overall financial situation are not usual practice.

Consumers are not required to state the purpose of the loan.

Consumers are generally pleased with the lack of detailed inquiry involved with a payday loan. However this does raise the issue of whether payday loans might breach s.70(2)(1) of the Code if adequate inquiries into overall financial circumstances are not made.[144]

6.2.3 Identification & Credit Checks

Identification requirements for a first loan are reasonably consistent across the industry. Most lenders require 100 points of ID: some form of photographic identification, proof of address and proof of income either in the form of payslips or a statement from Centrelink. Some lenders do not require photo ID.

Additionally, many lenders ask for the names of 2 or 3 referees, which cannot include relatives living with the borrower. A contact number of the borrower's employer is often required. Lenders routinely contact employers by telephone to confirm employment and income.[145]

Some lenders also take photographs of consumers to place on file, although this practice appears to be mainly at the discretion of the lender and is not applied to all consumers.[146]

Repeat borrowers generally do not need any form of identification other than a bank statement proving they have repaid their previous loan.

Submissions by the payday lending industry to the Queensland inquiry stated credit checks with Credit Advantage were not frequently undertaken and this would appear to still be the case.[147]

Payday loans are predominantly unsecured, although there is evidence of security being required for larger payday loans in Victoria.[148]

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[141] Telephone survey, Blue Star Capital Sunshine, 26 October 2001.
[142] Consumer interviews PDL 012 & PDL 014.
[143] Telephone Communication with John McKenna, Director, *ChequEXchange Frankston*, 4 February 2002.
[144] *Consumer Credit Code* 70 (2)(1)
[145] Consumer interview PDL 011; Consumer interview PDL 009.
[146] Consumer interview PDL 012; Interview with Jackie Galloway, Peninsula Community Legal Centre, 29 October 2001.
[147] Queensland Office of Fair Trading, 2000, above note 42, p. 9.
[148] Interview with Jackie Galloway, Peninsula Community Legal Centre, 29 October 2001; for discussion of this issue in Queensland see Queensland Office of Fair Trading 2000, above note 42, p. 18.

6.2.4 Loan size and contracts

The lender determines the size of the loan after assessing the consumer's income. Some lenders set a limit on the maximum size of a first loan. For example Blue Star Capital Springvale claimed it would not lend in excess of $200 to first-time borrowers. Repeat borrowers can request higher sums.

Documentation has to date been only haphazardly supplied to consumers. Former *ChequEXchange* branches usually issue borrowers a repayment 'card' stating the size of the loan and the dates repayments are due. *AMX* and *Blue Star Capital* have issued contracts outlining penalties for late payment and conditions of the loan.

With payday loans coming under the Uniform Consumer Credit Code more comprehensive contract documents are being issued to consumers. Borrowers must now be issued with an information statement outlining their right to a pre-contractual statement, a written copy of the contract, and options available to them if they are unable to repay.[149]

6.2.5 Repayment methods

Most lenders strongly encourage consumers to repay by direct debit although there are some who allow repayment in cash. Even where both options are available consumers are still required to sign a direct debit authority.

The use of direct debit in the repayment of payday loans is cause for concern for several reasons. These are:

- Banks will inevitably dishonour the direct debit when the borrower has insufficient funds in their account leading to substantial penalty fees in addition to the cost of the loan;
- Most people are unaware that they can cancel the direct debit authority without the knowledge or consent of the lender; and
- The direct debit gives the payday lender first priority on the borrower's income, quite possibly at the expense of essentials such as rent and food[150]

In a more general sense community workers have noted that low-income consumers tend to prioritise payday loan repayments at the expense of other essentials in order to maintain a 'line of credit'.[151]

Consequently default rates are reported to be relatively low. One business operator estimates 10% of his loans end in default, while the industry submission to the Queensland inquiry suggested an even lower default rate of 2-3%.[152]

Low default rates make the argument that high charges are necessary (as low-income consumers are 'high risk'), a rather tenuous one.

It should also be mentioned that several consumers reported some flexibility from individual payday lenders, not involving additional charges, in instances where they were unable to repay loans on the due date.[153]

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[149] CBAV 2001, 'Payday lenders and the consumer credit code', Fact Sheet, October http://www.consumer.vic.gov.au
[150] Interview with Jackie Galloway, Peninsula Community Legal Centre, 29 October 2001.
[151] Interview with Diana Bannister, Good Shepherd Youth & Family Services, 6 December 2001.
[152] Telephone Communication with John McKenna, Director, *ChequEXchange Frankston*, 4 February 2002; Queensland Office of Fair Trading 2000, above note 42, p. 11.
[153] Consumer interview PDL 004; Consumer interview PDL 016

6.2.6 'Roll-over' and 'back-to-back' loans

Loan 'roll-over' refers to the practice whereby a borrower pays the interest sum on the loan in order to 'roll-over' the loan for an additional period. This is an issue of great concern in the US, where several states have regulations limiting the number of times loans can be rolled over.[154]

'Roll-over' appears to have been practised by payday lenders, particularly by branches of AMX, during the initial stages of the industry in Victoria. It is currently only practiced by 1 lender in Victoria. All other lenders require the loan to be repaid in full before they will process another loan. Some lenders have a 'cooling off' period between loans of 2 to 3 days.

The most common form of repeat borrowing in Victoria is 'back-to-back' loans. That is consumers request another loan immediately after having repaid the initial loan. The process is perhaps best described by one consumer.

> *…you went up to the counter and you gave them your name and they'd bring you up on the computer. They'd say ok you pay such and such and you'd put your money through under this thing, this funny little thing. And then they would get a receipt typed up for you and poke that through back under to you. And then you'd say look I'd like to get some more again. Then they would type up a thing and that would come out and they'd photocopy it and you'd sign 2 copies, one for them and one for you, and after that they would hand the money to you. And that was it…*

This is a common procedure in Victoria that takes as little as 2 minutes. It can create cycles of debt similar to those caused by roll-overs. This issue is discussed in Chapter 8.

6.3 Advertising & Marketing

Payday lenders in Victoria have used television, radio and newspaper advertisements, flyers, shop design and a variety of incentive schemes to promote their product. When the industry first appeared in Victoria full page 'advertising features' appeared in numerous local newspapers.[155] Subsequent advertising has been clearly directed at low-income earners under financial stress. Sample slogans include:

> *Bills Galore and No Ready Cash?*
>
> *Rent Due and No Cash? No need to stress!*
>
> *Rent Due! Telephone Bill Due! Rates Due! Car Licence Due! Power Bill Due! Gas Bill Due! Lets Face It, You Need Some Cash!*

Marketing is also targeted at consumers with damaged credit ratings. One lender advertises that there are 'no credit checks' and 'no assets required'.[156] All lenders stress the speed of processing payday loans and the words 'quick' and 'instant' feature prominently in advertising material. One lender has conducted a targeted 'Christmas campaign', while another has specifically advertised that payday loans can be used to meet the costs of school fees.[157]

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[154] CFA/USPIRG 200, above note 24, p. 9.
[155] See for example *Northcote Leader* 2000, 'New source of quick cash for Victorians', 24 May, p. 11.
[156] Money Plus flyer, collected December 2001.
[157] *Frankston Standard* Christmas Wraparound 2000, 4 December, p. 3; I. Royall 2002, 'Payday sharks circle families', *Herald Sun*, 5 April, p. ?.

6.3.1 Store Design

Store design explicitly mimics that of mainstream financial service providers. AMX franchise literature states branches are to be of 'a standard appearance similar to a bank/building society/credit union'.[158] Fit-out and signage costs are estimated to average $110 000 per store.[159]

Bright interiors, writing desks and glass teller screens emphasise the image of payday lenders as 'mini-banks'. The image of a mainstream financial services provider is further reinforced by staff attire closely approximating that of major banking institutions.

The 'professional' image projected by store design engenders confidence in consumers that they are using a legitimate credit provider. Moreover store designs attempt to position payday lenders within the financial services mainstream, thereby attempting to counteract the negative imagery of 'loan sharks' associated with fringe credit.[160]

6.3.2 Incentive schemes

Incentive schemes to attract borrowers and encourage continued borrowing were introduced by *AMX* and continued with *Blue Star Capital*. Blue Star Capital's 'membership fee', aside from increasing the repayment on a first loan, also functions as an incentive to take further loans with Blue Star.

In response to a telephone enquiry, *Blue Star Capital* Springvale also suggested that 'charges and fees' would decrease over time as additional loans were taken with the company. AMX Sunshine also ran a 'Double your Money' offer between April and September 2001 for 'valued customers' offering '50% of your fee' on the sixth loan.[161]

In addition both *AMX* and *Blue Star Capital* have offered introduction schemes whereby existing members are given discounted rates for bringing new borrowers to the franchise.[162]

A further means by which such services are marketed to consumers is through the prospect of building up a credit rating.[163] This can appear to be a powerful incentive to consumers who have been rejected by mainstream credit providers precisely for this reason, and who may have been either bankrupt or have a damaged credit record elsewhere. Consumers are thus promised that for prompt payment and continued custom they will be rewarded with a future 'line of credit' with the provider.

Many payday lenders also have regular prize draws for 'valued customers' with prizes including linen, CDs, champagne and complimentary dinners.

6.4 The Geography of Payday Lending

Consumer advocates have generally argued payday lenders deliberately target low-income consumers. Such targeting occurs not only through advertising and marketing but also through business location. Although the industry strenuously denies this charge, payday lending businesses are predominantly located in socially disadvantaged areas, or in close proximity to pockets of disadvantage within more affluent suburbs.[164]

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[158] http://www.australianmoneyexchange.com/franchising.html

[159] AFSA 2001, above note 90, p. 5.

[160] The attempt to project a professional image is also evident in the pawnbroking industry. See V. Ayres-Wearne 2000, 'Last-resort lenders aim for retail image', *Consumer Rights Journal*, May/June, p. 15.

[161] Email communication, Phil Lennon, Financial Counsellor, 10 April 2001.

[162] Consumer interview PDL 007

[163] The 'rating' relates only to the payday lender, however many consumers interviewed believed it to be applicable to accessing other forms of credit.

[164] Field 2002, above note 44, p. 37.

In Melbourne and Geelong payday lenders are located in shopping strips, usually in close proximity to pawnbrokers and bank branches. AMX specifically advised intending franchise operators to locate 'in the same vicinity of Financial Institutions generally and other cash lenders such as pawnbrokers'.[165] Subsequently payday lenders have followed a pattern of concentration in lower socio-economic areas similar to that already established by pawnbrokers.[166]

In Melbourne payday lending businesses are located in some of Melbourne's most disadvantaged postcodes. Locations such as Glenroy, Sunshine, Dandenong and Frankston all have significant concentrations of low-income earners. Moreover, the shopping strip locations of many payday lenders are frequently surrounded by adjoining suburbs of equal or greater disadvantage. For example, Sunshine is immediately adjacent to Braybrook, rated by a 1999 study as the most disadvantaged postcode in Victoria. Similarly Dandenong is immediately adjacent to Doveton, a suburb rated by the same study as the State's eighth most disadvantaged.[167]

The location of payday lending businesses has also proved sensitive to the spatial trend of lower-income earners moving towards the urban fringe.[168] Indeed the highest turnover businesses are located on the metropolitan edge. Dandenong and, until the recent demise of Blue Star Capital, Frankston, are the only Melbourne locations to have multiple payday lending businesses in the same vicinity. A similar congregation of payday lenders is evident in Geelong, a regional industrial centre with high unemployment due to the contraction of the manufacturing and service sectors, and a high concentration of public housing tenants.[169]

However recent studies suggest substantial pockets of disadvantage remain in inner-city areas.[170] This explains the existence of payday lending businesses in inner-urban locations such as Brunswick and Collingwood. It is most clearly demonstrated by the Collingwood business, which is located between 2 major public housing blocks.

There are several payday lending businesses in less disadvantaged locations such as Croydon and Greensborough. However the highest number of loans are transacted in disadvantaged locations. The branches of *Money Plus* with the highest volume of transactions are those located in Dandenong and Geelong.[171] On balance it seems abundantly clear payday lending businesses have located in lower socio-economic areas where their largest pool of potential customers reside.

6.5 Summary

The following key points on the payday lending industry in Victoria may be noted:

- There are presently 16 payday lending businesses in Victoria, 14 in Melbourne and 2 in Geelong;
- An estimated 750-800 payday loans are transacted across Victoria every week;
- There are approximately $10 million in payday loan transactions per annum;
- There is considerable volatility in the payday lending industry;
- The current trend is towards product diversification, with many lenders offering car loans and longer term loans;

[165] http://www.australianmoneyexchange.com/market.html
[166] Ayres-Wearne 2000, above note 37, p. 17.
[167] Tony Vinson 1999, *Unequal in Life: the distribution of social disadvantage in Victoria and New South Wales*, Ignatius Centre for Social Policy and Research: Richmond VIC, pp. 53 & 56.
[168] R. Fincher & M. Wulff 1998, 'The Locations of Poverty and Disadvantage' in *Poverty Then and Now*, pp. 152-153.
[169] L. Johnson 1996, 'Restructuring and socio-economic polarisation in a regional industrial centre', in *Restructuring Difference: Social Polarisation and the City*, K. Gibson, M. Huxley, J. Cameron, L. Costello, R. Fincher, N. Jamieson, L. Johnson, & M. Pulvirenti (eds), Working Paper No. 6, Australian Housing and Urban Research Institute: Melbourne, pp. 43-57.
[170] Fincher & Wulff 1998, above note 168, p. 154.
[171] Telephone communication with Mr Rob Bryant, *Money Plus*, 30 January 2002.

- Annualised percentage interest rates on a $200 loan taken out over 14 days ranged between 585% per annum and 897% per annum;
- Identification requirements are reasonably uniform across the industry;
- Direct debit is the preferred payment across the industry although some lenders do permit cash payments;
- There is considerable variation in the minimum level of income required to obtain a loan;
- The most common form of repeat borrowing in Victoria is ‘back-to-back’ loans;
- Advertising is clearly targeted at low-income consumers under financial stress;
- Store design emulates that of mainstream financial institutions; and
- Businesses are predominantly located in socially disadvantaged areas, or in pockets of disadvantage within medium income suburbs

7. Payday Loan Consumers: A Statistical Profile

Discussion of who uses payday lending in Australia has to date relied mainly on data drawn from U.S. studies. As is the case in the U.S., industry representatives in Australia have claimed that their customer base is 'from all walks of life and socio-economic groups'.[172]

However consumer advocates maintain that the location of shopfronts, advertising methods and design of the financial product make it abundantly clear that payday loans are targeted at low-income consumers.

The data collected from a street survey of payday loan consumers conducted in November and December 2001 is presented in this chapter. This data sheds light on who uses payday loans and why.

This data is most usefully understood in conjunction with the qualitative data presented in the following chapter, where consumer motivation, experience and behaviour are examined in greater detail using evidence from in-depth interviews.

7.1 Who uses payday loans?

From the questionnaire results a broad picture of the average payday loan consumer emerges. It is useful to sketch this picture at the outset to provide some context for the statistical information that follows.

- The average payday loan consumer is equally likely to be a male or female in their late twenties or early thirties, Australian-born and from an English speaking background;
- They will earn about $24 000 a year and will borrow $250 for between 2 and 4 weeks;
- If they are male their income will be from a full-time job; if they are female their income will be from a Centrelink allowance, probably a sole parenting payment;
- The loan will be to cover bills or for day-to-day living expenses;
- They will most likely get more than 1 loan and, if they do, they will probably get 6 payday loans over the next 12 months

These broad findings are discussed in greater detail in the following sub-sections.

7.1.1 Gender & Age

Men and women were equally likely to be payday loan consumers. Women were slightly more frequent consumers and accounted for 52% of all survey respondents. Men accounted for 48% making no marked difference.

The average payday loan consumer is likely to be in their late twenties or early thirties. Thirty-eight percent of those surveyed were aged between 26 and 35. The next most frequent age group were those aged in their late thirties and early forties. Those aged between 36 and 45 accounted for 25% of respondents.

Younger payday loan consumers were a smaller though still significant group. Twenty percent of respondents were aged between 18 and 25. There were very few older consumers, with only 3% being over 56 years of age. In both these cases, the respondents were male.

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[172] Queensland Office of Fair Trading 2000, above note 42, p. 15.

The gender of payday loan consumers in the 2 most frequent categories was more or less balanced. There was a marked difference in the gender of consumers in the 46-55 category. Ten respondents fell into this category, 14% of all responses. Of these, 7 were women. Women in their late forties or early fifties were therefore significantly over represented.

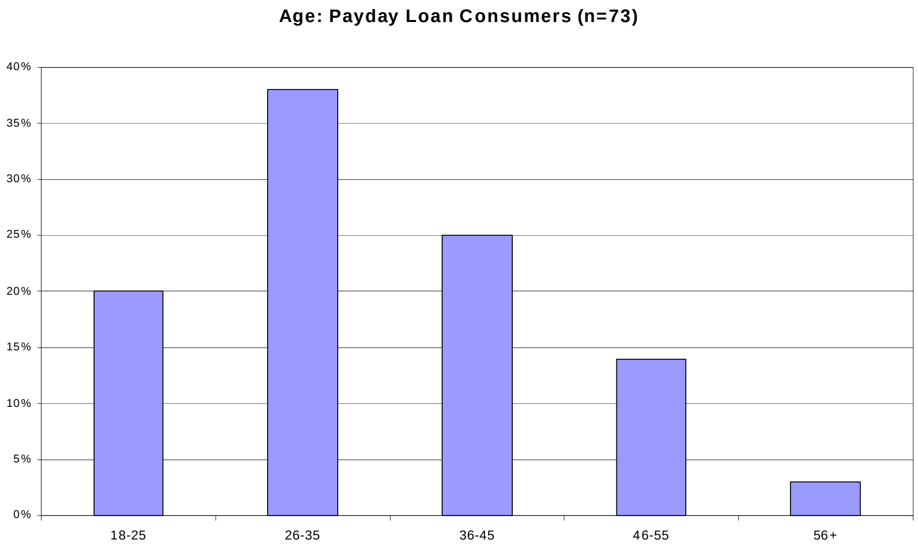

Figure 1

7.1.2 Source of Income

49% of consumers reported their source of income as being full-time employment. A further 12% reported their source of income to be either part-time or casual employment. 38% of consumers were in receipt of Centrelink benefits.

Exactly half of those in receipt of Centrelink benefits were receiving the sole parenting payment. However there were marked differences between the income sources of male and female payday loan consumers.

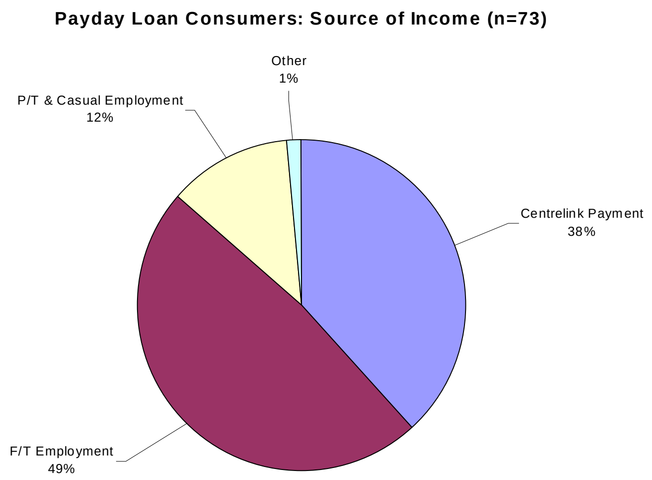

Figure 2

The main source of income for 55% of female consumers was a Centrelink payment, contrasted with only 20% of male consumers receiving Centrelink payments. This is graphically demonstrated by Figures 4 & 5.

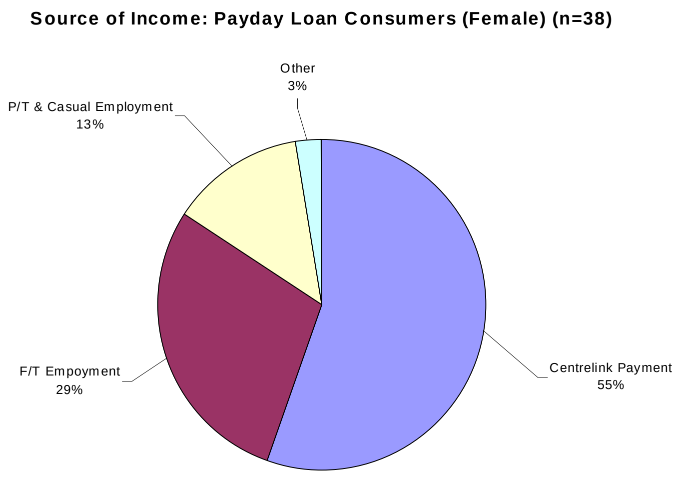

Figure 3

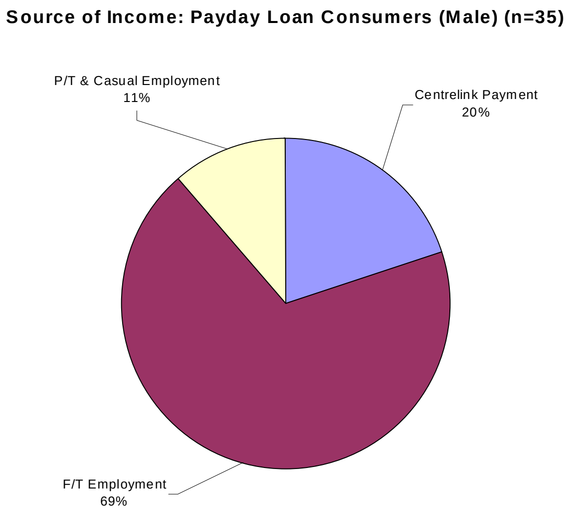

Figure 4

7.1.3 Size of Income

The question of borrowers' income remains central to the current debates on payday lending. The major question posed is whether payday loan consumers can be assumed to be low-income consumers.

There is little data on the question to date in Australia, although several U.S. studies support the general conclusion that payday loan consumers are overall low-income consumers.[173]

It must be added that when the geographic locations of businesses in Victoria, and the financial product they offer, are taken into consideration it seems objectively clear that businesses both attract and cater to a predominantly low-income client base.

There were 72 responses from payday loan consumers to this question (Section B Q.4) of the questionnaire. As data was self-reported, figures can be assumed to be approximate only. Nevertheless they do provide a good indication of the general earnings pattern of consumers.

The results of the questionnaire support the conclusion that those taking out payday loans are predominantly low-income consumers. The average weekly income of consumers was $470.80 and the median weekly income was $430.

Put in annual terms, the yearly earnings of the average payday loan consumer are $24 482. The median payday loan consumer earned somewhat less, with an annual income of $22 360.

[173] See Illinois Department of Financial Institutions 2000; State of Wisconsin Department of Financial Institutions 2001.

Weekly Income: Payday Loan Consumers (n=72)

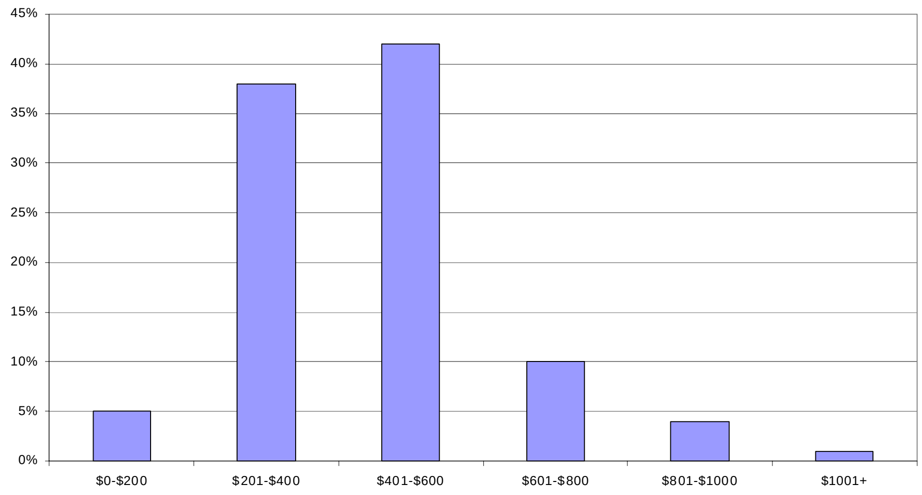

Figure 5

It is worth noting that 43% of payday loan consumers earn below $401 per week ($20 852 per annum). 85% earn less than $601 per week ($31 304 per annum).

22% of payday loan consumers had an income of $300 per week or less, placing them either below or only marginally above the Henderson Poverty Line for a single person ($15 600 per annum).

Indeed, given that 38% of payday loan consumers are receiving Centrelink benefits that are all below the Henderson Poverty Line, the number of consumers using payday loans who are in poverty is significant.[174]

Those in employment (61%) are likely to be working in low-paying jobs. 64% of payday loan consumers who were employed earned less than $550 per week, and 25% earned less than the Federal Minimum Living Wage of $413 per week.[175]

It is beyond the scope of the present inquiry to enter into the heated debates surrounding the measurement and definition of poverty.[176] The central point is that most payday loan consumers are low-income earners.

There are a small minority of payday loan consumers who could be classified as medium and high-income earners. 15% of respondents reported a weekly income above $600 and 5% had an income over $800 per week. The highest reported income was $1500 per week.

It would be a reasonable assumption that this group comprises individuals with impaired credit ratings or other financial difficulties. This was confirmed, as several respondents in this category also participated in in-depth interviews. This issue is discussed in more detail in Chapter 8.

As defined by income there are 2 main groups using payday loans:

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[174] Brotherhood of St. Laurence 2001, *Poverty Line Update*, Information Sheet No. 3 www.bsl.org.au The Henderson Poverty Line weekly income for a single person in August 2001 was $278.04

[175] ACTU 2002, *Living Wage Claim 2002 Information Kit* http://www2.actu.asn.au/campaigns/livwage/LIVKIT.pdf (accessed 3 February 2002)

[176] For a discussion see P. Saunders 1994, *Welfare and Inequality: National and International Perspectives of the Australian Welfare State*, Cambridge University Press: Cambridge, pp. 221-230.

- Low-income consumers; and
- Medium-income consumers with impaired credit ratings

7.1.4 Marital Status & Dependents

Over half (55%) of payday loan consumers were single. This was more the case for male consumers, with 65% of all male consumers being single. 42% of all female consumers were single.

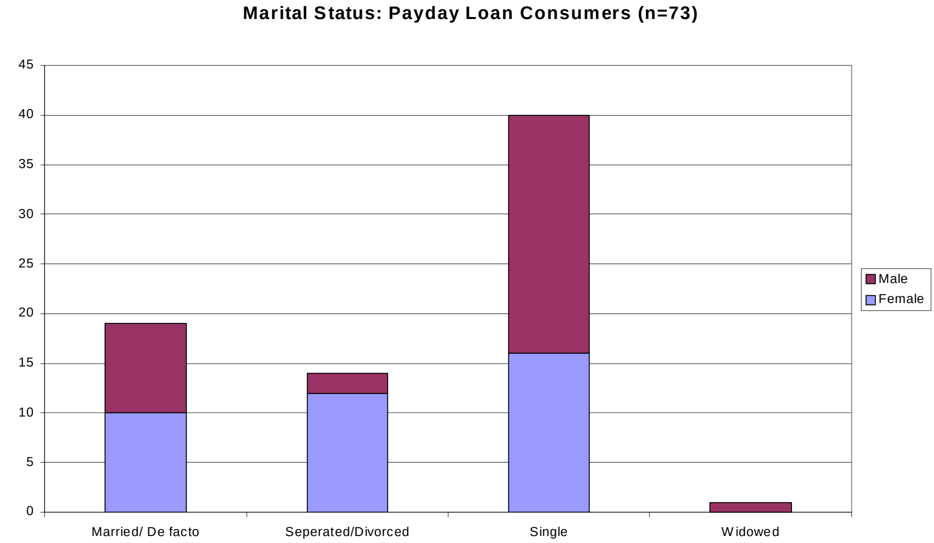

Figure 6

Payday loan consumers who were either married or living in de facto relationships comprised 26% of the total, with no marked difference between men and women as can be seen in the above chart.

However a major gender difference emerges amongst consumers who are either separated or divorced. Separated or divorced male consumers accounted for only 6% of all male consumers. However separated or divorced female consumers accounted for 31% of all female consumers.

This figure is even more significant when it is considered that 92% of separated or divorced female payday loan consumers also have dependent children. This suggests that female sole parents are a significant minority of payday loan consumers. This becomes even clearer when the information about dependents is considered.

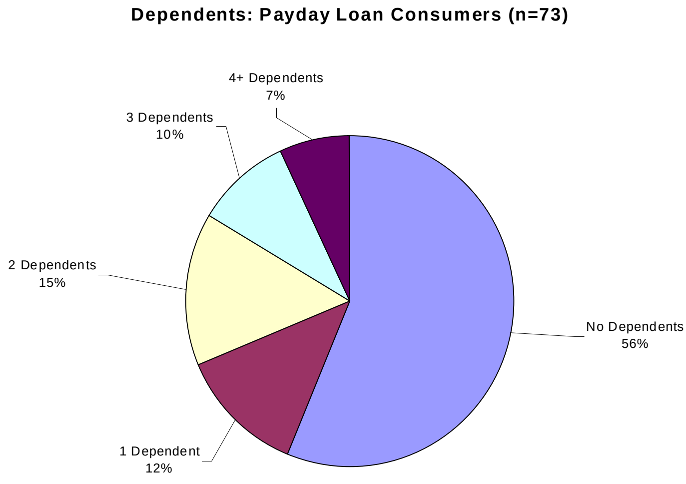

Figure 7

Overall 44% of payday loan consumers have dependent children. As illustrated above, 12% have 1 dependent child, 15% have 2 dependent children, 10% have 3 dependent children and 7% have 4 or more dependents. The highest number of dependents for any consumer was 6.

Female consumers were far more likely to have dependent children. Sixty-three percent of female consumers had dependent children, compared to only 23% of male consumers.

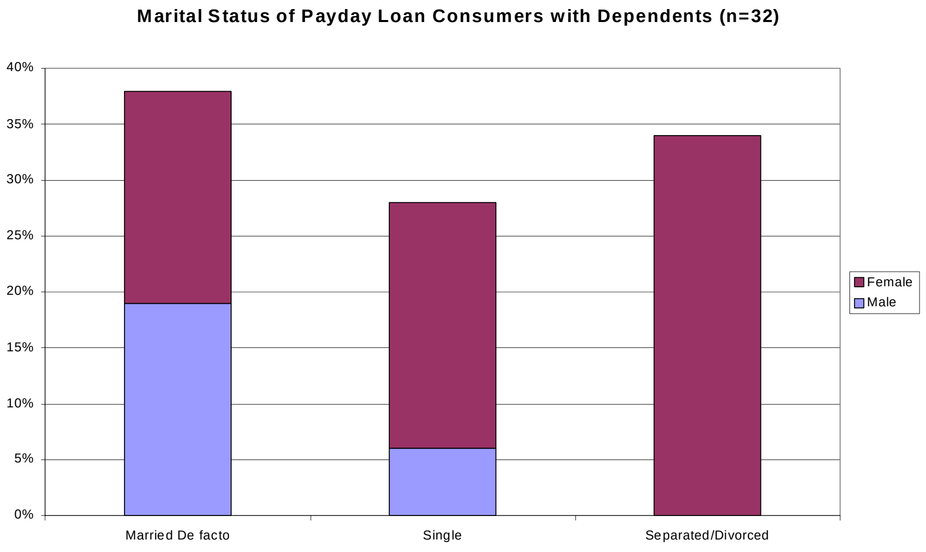

Figure 8

As can be seen from the chart, single, separated and divorced women with dependent children are a significant sub-group of payday loan consumers. Overall one quarter (25%) of all payday loan consumers are female sole parents. 47% of all female payday loan consumers are sole parents.

It is also significant that 78% of sole parent payday loan consumers reported Centrelink benefits as their main source of income. This explains the high percentage (55%) of female consumers with Centrelink payments as their main source of income.

There are several reasons why sole parents form a prominent sub-group. These are:

- Centrelink parenting payments are above the minimum level of income accepted by most payday lenders; and
- The burden of dependents' education and health on a fixed low-income creates acute financial stress and a need for short term credit

These issues are discussed in more detail in Chapter 8. However the central point for statistical purposes is that female sole parents are a distinct and identifiable sub-group of payday loan consumers.

7.1.5 Accommodation Type

Payday loan consumers are overwhelmingly renters with very few respondents owning or purchasing their own home.

80% of respondents were living in rental accommodation. Of these 51% lived in private rental premises, while a substantial 29% lived in public rental accommodation.

Only 13% of respondents were purchasing their own home. A further 7% lived in other forms of accommodation which included living with parents, boarding and temporary accommodation.

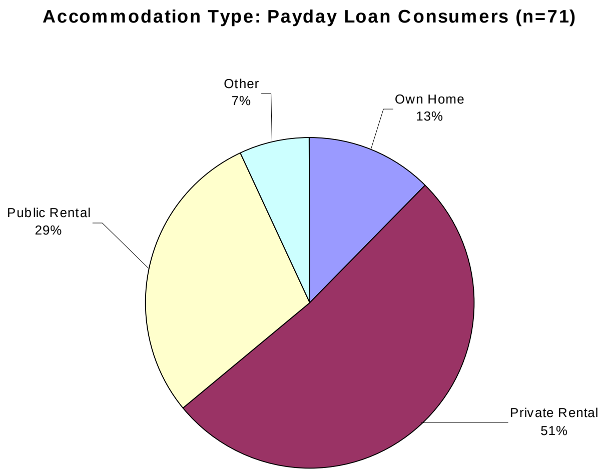

Figure 9

Payday loan consumers are relatively stable, with 82% having lived at their present address for longer than 12 months.

7.1.6 Education

Payday loan consumers had a lower level of educational attainment than the Victorian population as a whole. However they were more likely to have a vocational qualification than the general population.

36% had no secondary education beyond Year 10. One respondent had no schooling at all, while 13% had left school prior to Year 10. Exactly one quarter (25%) of respondents had left secondary school in Year 10.[177]

37% of respondents left secondary school in either Year 11 (18%) or 12 (19%) and had no further education.

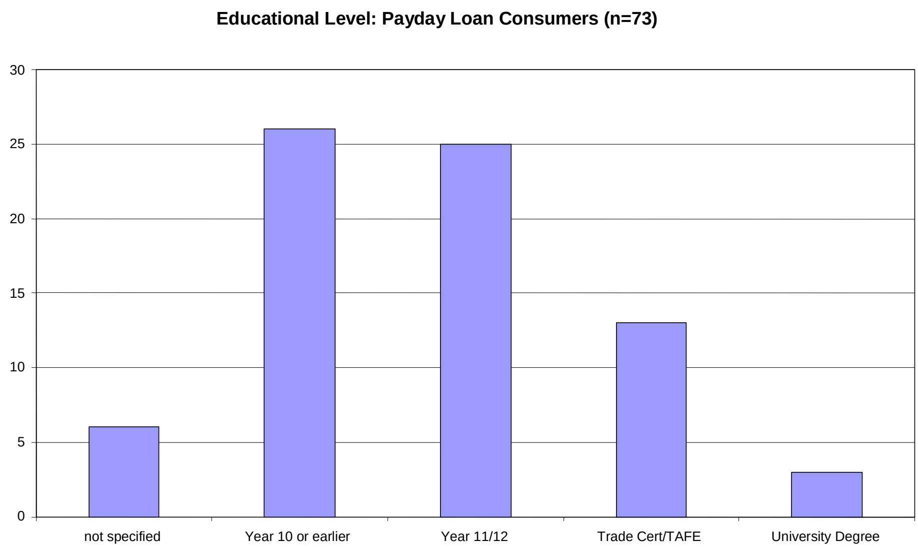

Figure 10

Overall 76% of respondents had no formal qualifications, a higher number than the Victoria-wide figure of 58%.[178]

Of those with post-secondary qualifications 19% had attained a trade certificate or other TAFE qualification. This was higher than the 12% of all Victorians who reported vocational qualifications.

5% of respondents had obtained a university degree. This was significantly below the 17% of the Victorian population who hold a degree or diploma from a university.[179]

[177] Statistics calculated using questionnaires on which question completed (n=67)
[178] Department of Infrastructure Victoria 1998, *Melbourne in Fact: 1996 Census Statistics for Melbourne's Local Government Areas*, DOI: Melbourne, p. 15.
[179] Department of Infrastructure 1998, above note 178, p. 15.

7.1.7 Ethnicity

The questionnaire results did not suggest any ethnic community utilising payday loans disproportionately. 71% of all respondents were Australian born equating fairly closely to State and National percentages (73% and 74% respectively).

New Zealanders were slightly over represented accounting for 7% of respondents, while those from the United Kingdom were slightly underrepresented being 4% of all survey respondents.[180]

The 'other' category included single respondents from Russia, Croatia, South Africa, Egypt, Greece, Hong Kong, India, Mauritius, Sri Lanka and Vietnam.

There were 2 respondents from Western Samoa accounting for 3% of all responses. However observation reports from surveyors in the Dandenong area suggest the Pacific Island community may be frequent payday borrowers. Nevertheless this would require additional research before any conclusive comments could be made.

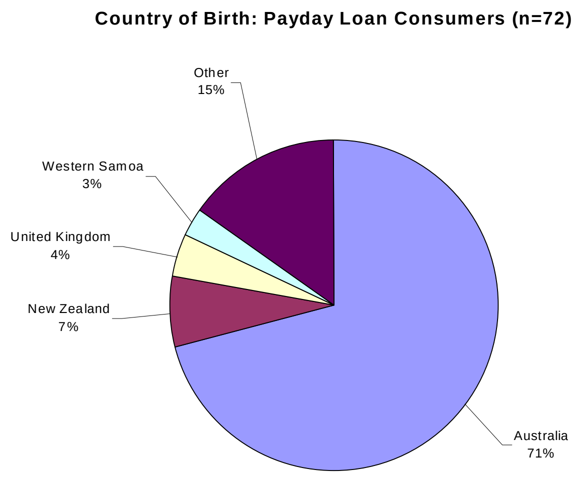

Figure 11

[180] Department of Infrastructure 1998, above note 178, p. 14; At the 1996 Census 1% of the Victorian population were born in New Zealand and 5% in the United Kingdom.

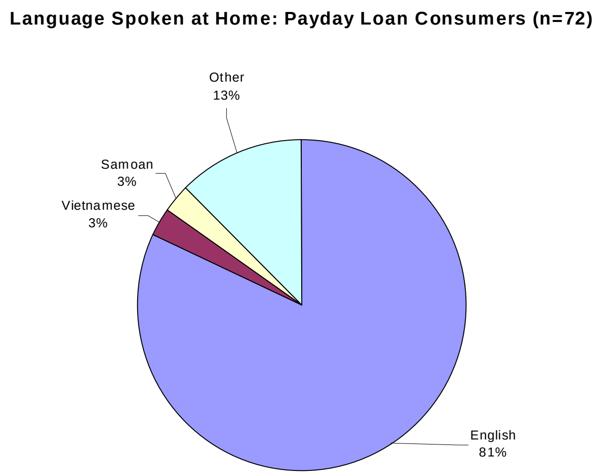

Figure 12

81% of all respondents spoke English at home, slightly above the percentage across Victoria (77%), and significantly above the percentage for metropolitan Melbourne (71%).[181]

Two respondents (3%) spoke Vietnamese at home and 2 (3%) spoke Samoan in their household. Other languages spoken at home by individual respondents and recorded in the 'other' category included Arabic, Cantonese, Croatian, Greek, Hindi, Macedonian, Maltese, Russian and Spanish.

Overall payday lending consumers were more likely than the Victorian population as a whole to be Australian born and from an English speaking background.

7.2 Payday Loan Consumers: Borrowing Trends

Questions related to borrowing aimed to establish the following:

- Size of the loan;
- Period over which the loan was taken;
- The purpose of the loan; and
- Whether or not the consumer had taken out previous loans

Some general points may be made initially to pre-empt the statistics.

- The majority of consumers obtain payday loans of between $200 and $300 for 2 to 4 weeks;
- The vast majority of loans are for bills or living expenses;
- Over half of payday loan consumers will take out more than 1 loan;

[181] Department of Infrastructure 1998, above note 178, p.14.

- A significant minority will use payday loans more or less continuously; and
- Consumers will mostly use the services of only 1 payday lender.

7.2.1 Size of Payday Loans

The average amount of all the payday loans surveyed was $258.60. Loans ranged from as low as $45 to as high as $1000, with the median loan being $200.

The fairly self-evident point is that payday loans are for relatively small sums. Over half (52%) are for less than $250, and over 80% are for less than $350. It is worth noting however that size of the average payday loan is higher than loans obtained from pawnbrokers that are generally between $50 and $80.[182]

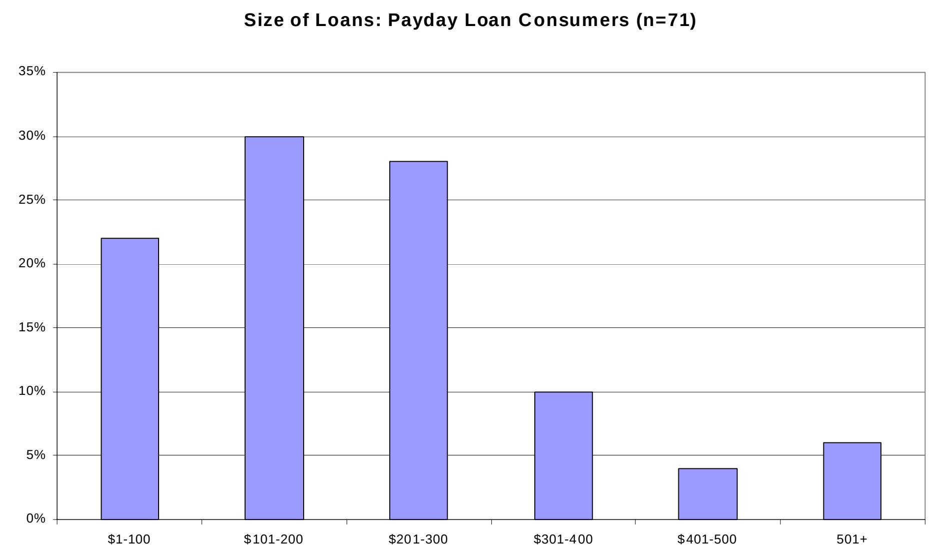

Figure 13

7.2.2 Length of Loans

Nearly half (44%) of payday loans were taken out of a period of 4 weeks. The next most frequent period was loans for 2 weeks which comprised 24% of all loans.

There were very few loans for periods of less than 1 week (3%) and also very few loans exceeding 4 weeks (6%).

Overall the majority of payday loans (77%) were taken out for periods of between 2 and 4 weeks.

[182] K. Densley & V. Ayres-Wearne 1997, *A Submission to the Review of the Pawnbrokers and Second-Hand Dealers Act (1989)*, Good Shepherd Youth and Family Services: Collingwood, p. 3.

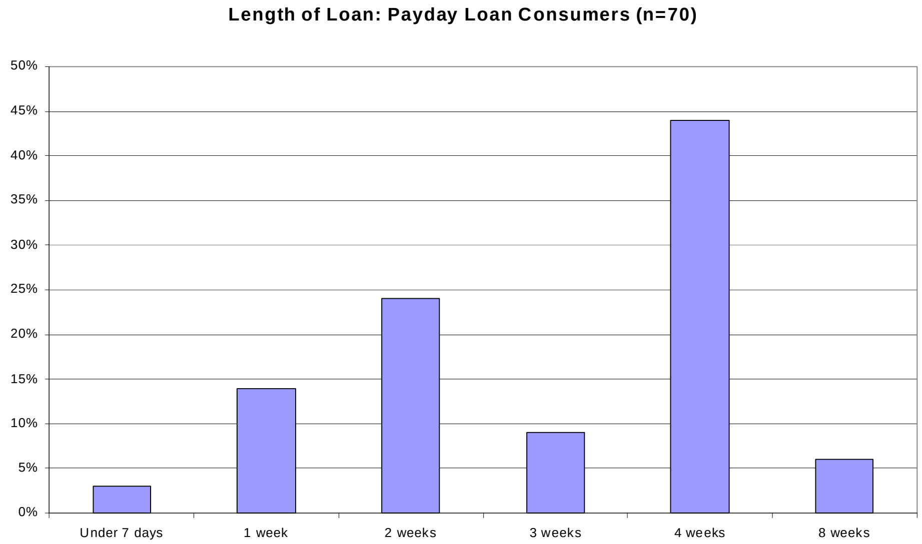

Figure 14

The length of loans is largely determined by the design of the payday loan financial product. Charges are calculated by 7, 14 and 28 day intervals.

The length of loan is also determined by the income payment of consumers, which are mostly paid fortnightly.

The popularity of 4 week loans is due to the fact that they are often repaid by consumers in 2 fortnightly instalments.

7.2.3 Repeat Loans

Sixty-five percent of consumers surveyed had taken out more than 1 payday loan. The average number of repeat loans taken out by consumers is 6 over 12 months. The median number of additional loans taken out was 5.

Twenty-eight percent of payday loan consumers had taken out between 1 and 4 loans in the past 12 months.

A sizeable minority of payday loan consumers use loans more or less continuously, with 37% of consumers having 5 or more loans within the previous 12 months.

Within this group of regular consumers there is a sub-group of consumers in a cycle of back-to-back loans. 15% of consumers had taken out 10 or more loans in the previous 12 months.

The highest number of loans reported by a consumer was 24, equating to 1 loan every fortnight for the previous 12 months.

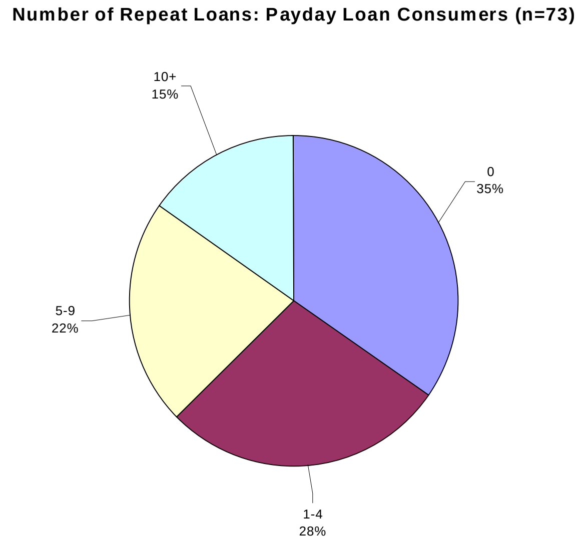

Figure 15

It should be noted that payday loan consumers overwhelmingly obtain their loans from only 1 payday lending business. Of all payday loan consumers surveyed (73), only 1 had obtained loans from more than 1 payday lender. In this the Victorian pattern differs from that found in U.S. research which suggests borrowing from multiple lenders is reasonably common.[183]

There are several factors that explain the consumer tendency to borrow repeatedly from 1 lender. These are:

- The design of payday loan products, particularly ‘membership fees’ and reduced rates on subsequent loans, encourages repeat borrowing;
- Second and subsequent loans can be obtained from the same lender in as little as 5 minutes and require minimal identification; and
- Consumers are informed that they are improving their credit ratings by repaying loans with 1 provider[184]

It should also be mentioned that there are currently only 2 locations in Victoria, Geelong and Dandenong, which have more than 1 payday lending business. Through simple logistics this would reduce the chances of consumers applying for loans from multiple lenders.

7.2.4 Purpose of Loans

The most frequent reasons cited for obtaining a payday loan were to pay bills and cover living expenses. 32% of respondents said they had taken the loan to cover bills; a further 26% said the purpose of the loan was to cover day-to-day living expenses.

[183] Stegman & Faris 2002, above note 25.
[184] For discussion of these issues see Chapter 8.

Several respondents were more specific about the bill to be covered. One consumer was obtaining a loan to cover veterinary bills, one to buy medication for a child, and another to pay for school books for a child.

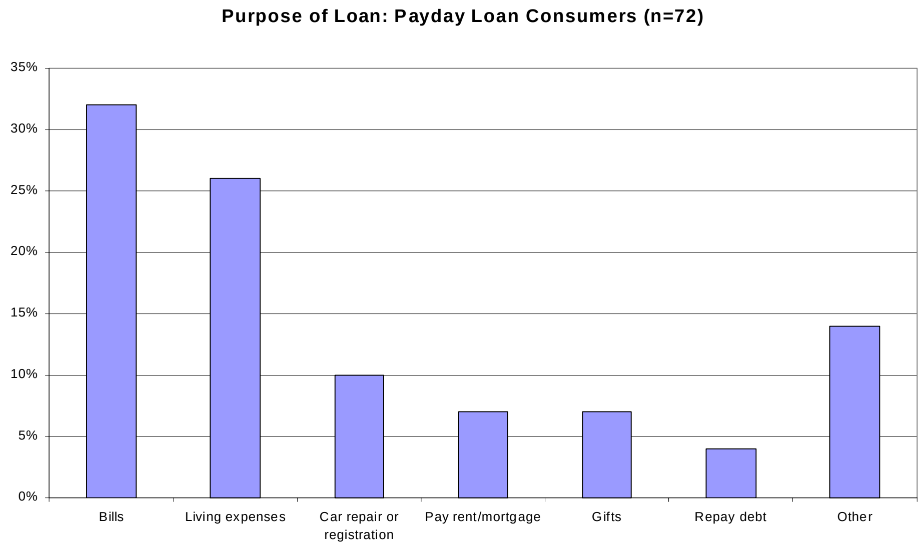

Figure 16

A further 10% stated that their loan was to pay for car repairs or registration. 7% were using the loan to pay their rent or mortgage. 4% of payday loan consumers used the money to repay existing debts.

Therefore 79% of loans are used to maintain existing living standards and compensate for shortfalls in income.

Given that the questionnaire was conducted close to the Christmas period, it is perhaps unsurprising that 7% of respondents were taking out a payday loan to purchase gifts.

14% of consumers gave other reasons for obtaining a payday loan. This category included 'personal' reasons, using funds to purchase a fridge, using funds for holidays or travel, to visit a sick relative, to finance moving house, and unspecified reasons.

The point remains however that very few consumers are using this form of short-term credit for a 'lifestyle' purpose. Payday loans are used to buffer shocks to income created by large bills and in many cases simply to meet regular household expenses.

7.2.5 Use of other credit sources

40% of payday loan consumers had used no other form of credit in the previous 12 months.

Overall 60% of consumers had used some other form of credit in the previous 12 months. 38% of consumers had used 1 other form of credit while 20% had used 2 or more sources of credit.

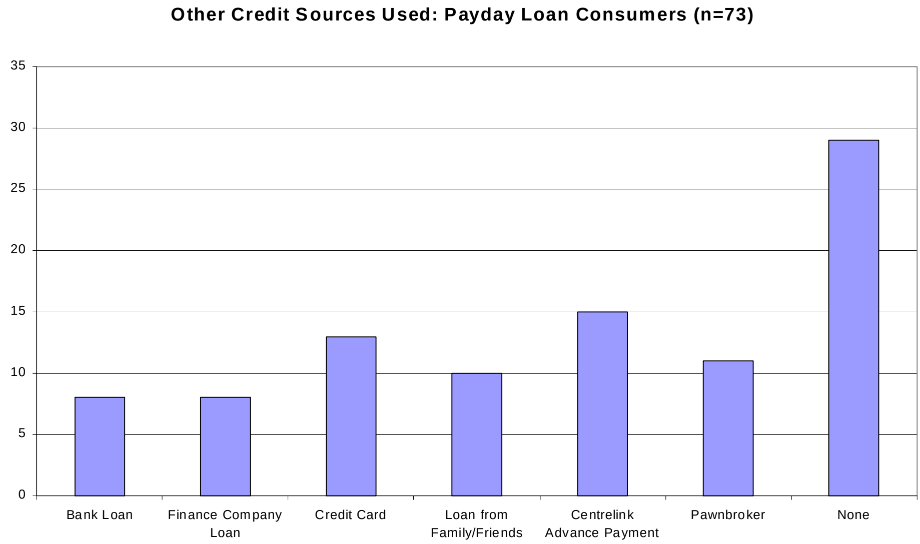

Figure 17

The most common form of credit used in addition to payday loans is the $500 Centrelink Advance Payment. 20% of consumers had received the $500 advance payment in the previous 12 months.

18% of payday loan consumers had used a credit card in the previous 12 months. Only 15% of payday loan consumers had used in a pawnbroker in the previous 12 months.

This is significant as it is often assumed that pawnbrokers and payday lenders are covering the same consumer base. This figure would suggest that this is not the case, and that payday loan consumers are a different group from those who use pawnbrokers.

Other sources of credit used included loans from family and friends (14%), finance company loans (11%) and bank loans (11%).

7.3 Summary

To summarise, the following key points emerge from the questionnaire results:

- Men and women are equally likely to be payday loan consumers;
- The average payday loan consumer is likely to be in their late 20s or early 30s;
- The yearly earnings of the average payday loan consumer are $24 482;
- 43% of payday loan consumers earn less than $401 per week;
- At least 38% of payday loan consumers live below the Henderson poverty line;
- 38% of payday loan consumers reported Centrelink payments as their source of income;
- 55% of female consumers reported Centrelink payments as their source of income;
- 31% of female consumers are separated or divorced;
- One quarter (25%) of all payday loan consumers are female sole parents;
- 47% of all female payday loan consumers are sole parents;
- 80% of payday loan consumers live in rented accommodation;
- 29% live in public rental accommodation;
- 76% of payday loan consumers have no formal qualifications;
- The average size of a payday loan was found to be $258.60;

- 80% of loans are for less than $350;
- 77% of loans are taken out for between 2 and 4 weeks;
- 65% of payday loan consumers had borrowed more than once;
- 37% of payday loan consumers reported having had 5 or more loans in the past 12 months;
- 79% of loans were used to pay bills or cover day-to-day living expenses;
- 20% of payday loan consumers had received the Centrelink Advance Payment in the previous 12 months;
- Only 15% had visited a pawnbroker in the previous 12 months

The following chapter relates the individual stories behind these statistics.

8. Payday Loans: The Consumers' Experience

This chapter contains material gathered from 12 in-depth interviews with payday loan consumers. Six of the participants were in full-time, casual or part-time employment while 6 were in receipt of some form of government benefit. Their ages ranged from 23 to 55. Ten participants could be classified as low-income earners, 1 participant was a lower middle-income earner and 1 participant had a higher middle-income.

On balance the participants represented a valid cross-section of consumers using payday loans. The conduct of interviews is discussed in Chapter 2 (Section 2.5) however it is worth reiterating the general questions asked of participants. Interview questions covered the following broad areas:

- The circumstances leading up to their first payday loan;
- The purpose of their payday loans;
- Their general experience and opinions of getting payday loans;
- Their perceptions of charges;
- Perceptions of charges in relation to other credit options; and
- Their views on potential credit options and alternatives

The interviewer did not proffer any opinions regarding the advisability or otherwise of using payday loans. The purpose of the interviews was to gain an understanding and insight into the consumer experience, not to offer financial advice.

Broadly, payday loan consumers are aware that they have few credit alternatives. They appreciate access to credit, but are aware that they pay a disproportionately high cost.

8.1 Becoming a borrower

Obtaining a payday loan is usually the result of ongoing financial problems. For the vast majority of consumers, payday loans are used to cover electricity and gas bills, automotive costs, rent and other living expenses. However they may first come to use payday loans through some financial 'shock' to fragile finances. There are also consumers who use payday loans because of a poor credit rating or existing credit over-commitment.

The following sections reveal some of the circumstances consumers have experienced that have led them to use payday loans as a form of short-term credit.

8.1.1 Life on a low-income

The evidence from in-depth interviews reinforced the findings of the street survey on the purpose of payday loans. Most payday loans are used to compensate for low-incomes and cover routine expenses for people whose outgoing expenses regularly exceed their income.

Richard, a factory worker, described his financial situation at the time of applying for his first payday loan.

> *…we weren't getting any overtime or anything. It was a just a weekly wage every week, plus the wife she wasn't getting any overtime and she only works in a clothing factory and everything. So the money we were getting was just enough to pay our mortgage every week and you know buy food and everything too. We couldn't save anything or put anything away for a rainy day…*

General financial hardship motivated most consumers to initially consider obtaining a payday loan. For some consumers these situations are particularly stressful.

…I was already kicked out of the house because of rent. It got me out of that. Electricity and gas, the phone was getting cut off and I borrowed money from ChequEXchange and they got me out of that…

Sue, a sole parent with a combined income from a Centrelink parenting payment and part-time casual work, describes the situation leading up to her first loan.

…I didn't have much money after I'd paid everything and I thought well I think I should go in there and at least I'll have a hundred, you know. It was a little bit more than I had but it wasn't that much, and I haven't stopped since…

Sharni also described the financial and personal stress caused by mounting bills and inadequate income. Sharni was unemployed for 3 years, but only began using payday loans after commencing employment for which she gets $420 a week. The backlog of debts accumulated during unemployment created acute financial pressure, leading her to apply for a payday loan.

…mainly with Telstra because they were threatening legal action and then Civic Compliance started sending me letters like you're going to jail and all that sort of thing and when I initially started getting all those letters I took them extremely seriously so I went into a state of panic and I think that's when I put the applications in…

General financial strain also underpinned many subsequent loans. As demonstrated in the previous chapter, 58% of all consumers reported taking out loans either to pay bills or cover day-to-day living expenses. One consumer, asked why the size of the loans they obtained frequently varied, gave an insight into the circumstances behind such loans.

…none of the bills got paid until they were absolutely desperate, and if it was a mid-pay week I didn't have any money I'd charge off to ChequEXchange you know, depending on how threatening the letters were, and get the money out to pay the bill. So that's why it would vary…sometimes I would take out the $300 because I needed to get food…

8.1.2 Emergencies

Those on low-incomes frequently have little or no savings to cushion against financial shocks such as unemployment, unexpected bills and unforseen expenses. These financial shocks often provide the initial motivation to seek out a payday loan. Several interview participants described such 'financial shocks' and how they led to getting a payday loan.

…I was running to work and I fell over and knocked this front tooth out, basically split it in two. And I had no money to get it fixed. So I went in to get money to get it fixed so I could get back to work…

…I'd just got the sack and I needed extra income. That's why I went for the first one, because I lost my job…

…my dog C____. She was pregnant and she was four days overdue and they were going to do a Caesarean. They wanted to know that I was going to pay. I gave them $200 and it's going to cost me over $450…

8.1.3 Impaired Credit and Over commitment

Interview subjects confirmed anecdotal reports that payday loan consumers are drawn from 2 broad categories:

- consumers with fixed low-incomes; and
- consumers with impaired credit ratings unable to access credit elsewhere

Several of those participating in interviews had either declared bankruptcy or had their credit ratings otherwise impaired. These consumers face a very limited range of options if they require credit. One consumer was clearly aware that she was forced to use expensive credit through lack of options.

> *…Banks are cheaper but when I started using them [payday loans] no one would touch me with a ten foot pole because of my credit rating and that was the major thing that sent me off to them at the time, because I couldn't get a loan, I couldn't get nothing…*

It should be noted that the 2 categories of consumer are not mutually exclusive. Several interview participants who were on a fixed low-income also had impaired credit ratings. As such they viewed payday lending as one of the few sources of credit available to them.

8.1.4 Parenting costs

Research confirms that sole parents are more likely to be poor than any other family type.[185] Sole parents also form 25% of all payday loan consumers, and their need for credit frequently stems from the financial strains of caring for dependents. Particularly prominent were the costs of education[186], amounting to sums that few thought they were able to afford.

> *…I had school books and school uniforms to go and get again. High school, it's not cheap. So I was still trying to pay off school fees and everything like that and I thought well, you know, try and get some of the fees down the road, cause I've got a grands worth of fees to pay! Where am I supposed to get the money for that?…*

The financial pressure for sole parents was particularly severe for women with teenage children, whose demands often significantly outstrip income. For example, Catherine receives a parenting payment and finds the costs associated with her 2 eldest children often exceed her income.

> *…my daughter's just been on camp that was two hundred and something. And then I had to get her all new clothes to go away with, new shoes. And then my son…everything's got to be you know two hundred dollar runners and…I'm just handing over money like two hundred bucks a week. Which I can't afford…*

Also mentioned in the course of interviews with sole parents were the pressures of health costs such as general medication and dental work.

> *…yeah it's just a bit tough at the moment. Like my daughter I've got to come up with eight hundred dollars in February for the orthodontist…*

Sole parents are particularly vulnerable to financial shocks, and seek payday loans as a means of meeting numerous expenses associated with their children's education and health.

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[185] S. Shaver 1998, 'Poverty, Gender and Sole Parenthood' in Fincher & Nieuwenhuysen (eds) *Australian Poverty: Then & Now*, Melbourne University Press: Melbourne, p. 289.

[186] For discussion of the increasing costs of education for low-income families see Brotherhood of St. Laurence 1999, 'Changes in Victorian schools and implications for lower-income families', *Submission to People Together: Public Inquiry into Public Education*, http://www.bsl.org.au/pdfs/peducatn.pdf (accessed 11 February 2002)

8.1.5 Gambling & other addictions

The links between gambling, addiction and forms of short-term credit such as pawnbroking are reasonably well documented.[187] This link has also been suggested for payday lending. The Queensland Report documented one payday lender whose advertising specifically targeted those with gambling problems.[188]

Financial counsellors also point out that there are many aspects of payday lending making it attractive to those with gambling problems. Gamblers wishing to hide their problem from a spouse may well look to a source of credit where they can access money with few questions asked. It is also the case that consumers with gambling problems do not always borrow money to gamble. They will often use the proceeds of a loan to replace income that has already been gambled.[189]

One consumer admitted that his gambling had driven him to seek payday loans and other forms of short-term credit.

> *…my biggest problem is that, like I said, I try too hard on the horses and tattslottos and that. I even went out and pawned some stuff a month ago. One of them was my wife's ring that I bought her…*

During the street survey a payday loan consumer was also observed going directly from a payday lender into an adjacent pokies venue.[190] Gambling can also be the cause of seeking payday loans in a less direct way, and one payday loan consumer was forced to seek short-term credit after his spouse's gambling had decimated family finances.

> *…my ex was always gambling anyway and when she left I was in about $4000 in debt not counting my own debts but just you know rent that she hadn't paid, she was supposed to pay bills and all that stuff and I was left with $4000 there and that's when I started using ChequEXchange. What was supposed to be going on rent and bills she was blowing on pokies during the day…*

Instances of payday loan consumers using credit to purchase heroin and other drugs of addiction are also reported by financial counsellors.[191]

Nevertheless, the observation of researchers during the street survey and their discussions with consumers suggest that the number of customers using loans for these purposes is not large. Some lenders also report that they are unlikely to lend to those suspected of having gambling problems due to the high risk of loan default.[192]

On balance, it would appear pawnbrokers are more likely to be a source of funds for gambling or drugs of addiction than payday lenders. The vast majority of payday loans are used simply to compensate for inadequate incomes and make ends meet.

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[187] A. Millmow 2000, 'Big pawns in the gambling game', *Age*, 7 October, p. 17; the following studies both suggest links between pawnbroking and problem gambling: Dempsey & Ayres-Wearne 1997, above note 37 and Ayres-Wearne 2000, above note 37.
[188] Queensland Office of Fair Trading 2000, above note 42, p. 9.
[189] Interview with Carmel Clay, Financial Counsellor, Good Shepherd Youth and Family Services, 6 December 2001; see also Cleary 1999, above note 40.
[190] Observation study, Sydney Road Brunswick, 29 November 2001.
[191] Discussion with Phil Lennon, Financial Counsellor, Smith Family Sunshine, 4 December 2001.
[192] Telephone communication with John McKenna, Director, *ChequEXchange Frankston*, 4 February 2002.

8.2 Loan Traps

Consumers repeatedly spoke of the ‘addictive’ nature of the loans. This was particularly the case following the first loan when their name was ‘on the books’ and processing time was minimal. Incentive schemes such as discounted interest rates for introductions of other customers and reduced interest rates for longer-term customers have been practiced by some lenders.

However the greatest incentive encouraging repeat borrowing (which 65% of payday loan consumers will experience) is the speed with which subsequent loans are processed. Indeed many consumers seemed truly surprised, and slightly uncomfortable, by how easy subsequent loans were to obtain and how rapidly they received money.

> *…you just walk in there you know, it’s just boom, bang, file done. ‘There you go darling there’s your money’ and that and you go…*

> *…second one was easier, just had to go back and say ‘look I want another loan’. Didn’t have to show no more ID cause everything was on record…*

> *…I’m in and out in five minutes…*

Some consumers even suggested the ease of subsequent borrowing was worrying and amounted to a temptation.

> *…it was too easy to get. It was just yeah walk in, ask for the loan and you’d pretty much as soon as you’d ask for the loan they’d look it up, yep this is how much you’d be paying, that’s all right, here’s your money…*

Consumers who have obtained numerous loans frequently reach a stage where they become aware that their payday loans are becoming problematic. Several consumers expressed a sense of powerlessness at their use of repeated loans.

> *…second time I pretty much paid it back and got the next one. Third one, yeah, I sort of took my time on that one. I thought nah I’m not going to get myself in a trap. But yeah, went back and got another one about a week and a half later and I’m going ‘Oh no what am I doing’…it was so easy to just go in there and ask for another loan, say ‘look can I grab another loan’…*

> *…really it’s a catch. I’m sucked in. If I go and tell my friends they’re going to get sucked in…like I know this girl, I know for a fact she’s just lock, stock and barrel in there. And so is her friend. I’ve seen her friend in there and she was trying to get more money off them one day, and I was standing behind her thinking you poor girl, this is terrible, but they have got you. I mean they had me too…*

> *…you know you can have that every second week, and it’s not a problem if you pay it. So that’s what becomes a trap. It’s another one of those chains that are just going, going, going and you’ve got to stop the chain and go ‘no I don’t need that anymore’. They can suck people in, like myself and single parents, single mums and things like that…*

Most consumers hoped they would not be using payday loans indefinitely. Several were actively attempting to stop using them but hadn’t done so as yet. Unfortunately, without a major change in income, this can be very difficult as the loans are so easily obtained and become absorbed into week-to-week budgets.

8.3 Customer Service

A repeated theme that emerged from the responses of all consumers interviewed was the high standard of customer service provided by payday lenders. Payday lenders have been quite explicit about this in their own literature. The commitment to customer service is taken quite seriously, and in this area it is clear that payday lenders have some lessons for mainstream financial services providers.

The importance of this to consumers cannot be overstated. Visually payday lenders mimic mainstream financial providers, and this heightens feelings amongst consumers that they are active participants in a commercial economy. As one consumer succinctly stated:

> *They were excellent in the way they treated you as a person. They didn't treat you in the way that you get treated because you're on a pension. They treated you as if you were a client that was worth being treated well…*

For vulnerable consumers who have previously felt socially and financially excluded simply being 'approved' for credit provides a significant boost to self-esteem:

> *…they were just really ready to help pensioners, you know. There was no 'oh well you're a pensioner no we don't want to know you' and that's the impression you get from a lot of places you go to for things you know…*

Further visits to payday lenders also involved a 'personalised' level of service. Consumers spoke favourably of their interactions with payday lending staff, and generally had pleasant recollections of their visits.

> *…in a way funnily enough it's like going in to see friends, I'm paying for it yes but they make you feel fairly comfortable and I have seen them dealing with people who do look really badly off and they seem to treat everyone the same…*

> *…it was a good atmosphere, very friendly. And you didn't have to wait at the counter for ages, generally someone was there…*

For most consumers there was no stigma attached to visiting a payday lender. They are viewed as a legitimate means of accessing credit and undoubtedly this perception is encouraged by the promotion and advertising of lenders.

This was not universally the case however. Consumers who had higher incomes and used payday loans due to a poor credit rating or credit over commitment viewed the process as somewhat embarrassing. Several interview participants were in this category and for them obtaining a payday loan was considerably less pleasant.

> *…I didn't want to see anyone I know. I would not have like to have bumped into a girlfriend or my daughter particularly. I suppose it's my kids I'm aware of. If you're doing that, you're desperate and you're in there sometimes with people who are obviously desperate for a lot of reasons other than mine…*

> *…I don't feel good going in there. If I saw someone going in there I would say they're broke or they must be in debt or something and I would go in there and people would be saying the same thing. I wouldn't use it unless I had to. I would go to the bank and get a loan…*

Nevertheless consumers in this category were as positive overall about the standards of customer service as those on lower incomes.

8.4 Costs & Comparisons

…they're a rip off, but they give you money…

…who else is going to lend to someone whose unemployed…[193]

The comments above bluntly encapsulate the consumer view of payday loans. All consumers interviewed considered the costs of payday loans to be high. Nevertheless consumers generally appreciate having a source of credit, and most have no, or at best, few alternatives and so see the high charges as the trade-off.

The following sub-sections deal with consumer comprehension of costs and their opinion of these costs.

8.4.1 Comprehension of costs

Consumers generally understand the cost of payday loans in straightforward dollar terms rather than in terms of an interest rate. Some evidence of this is provided by the results of the street survey. When asked the cost of their loan (Section A. Q.4) 78% of consumers gave a dollar figure, 14% did not know the cost of their loan and 7% gave an interest rate percentage figure.[194]

Where 'interest rates' were mentioned they referred to the amount of interest paid rather than the rate. This largely reflects the information which to date has been disseminated to consumers by payday lenders. During the telephone survey of payday lending businesses conducted for this project several lenders suggested that a charge of $22 on a $100 loan over 2 weeks was '22% interest'.[195] Consumers generally perceive the 'interest rate' the same way.

In terms of the transaction itself consumers felt lenders adequately explained the charges. Many consumers are given cards containing repayment dates and amounts owing, although only a few had received written contracts. A lack of 'truth in lending' has been a concern with the industry and was an issue investigated by the Queensland inquiry.[196] However, there was no substantial evidence of lending 'mischief' in Victoria. Interview participants knew how much they were required to repay and were generally aware of potential penalties involved with the loan.

Where consumers compared the charges of payday loans with other credit options it was generally with pawnbrokers and Cash Converters. Some were aware that the charges were significantly higher than bank loans, although none compared the cost of a payday loan with the interest charges on credit cards.

This returns to the initial point that payday loans are mostly understood in dollar terms. For this reason consumers frequently consider smaller loans over short periods to be significantly cheaper than larger loans over a longer period, even though the APR for larger payday loans of a month or more is often significantly lower.

The following statement of one consumer is indicative.

> *…to be honest I don't even know what the interest is. The money comes out of my account and basically that's it…*

Very few consumers had any comprehension of annual percentage rates (APRs). This probably reflects a more general lack of understanding of APRs in the wider community.[197]

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[193] Top quotation from street survey respondent, Geelong, 30 November 2001; lower quotation from street survey respondent, Glenroy, 21 November 2001.
[194] Section A Q. 4 had a total of 69 responses.
[195] Telephone survey, Blue Star Capital Springvale, 26 October 2001.
[196] Queensland Office of Fair Trading 2000, above note 42, p. 16.
[197] UK research on this issue has revealed a generally poor comprehension of APRs; see Kempson & Whyley 2000, above note 35, p. 33.

Only one consumer was able to calculate what the APR on a payday loan would be, but refused to do so as 'it would just annoy me'.

It is unlikely that the display of comparison rates or APRs on their own would deter consumers from using payday loans. Initial loans are usually accessed in situations of considerable desperation in which the notion of consumer choice has little meaning.

Asked if knowing the APR would have influenced their decision to get a payday loan, consumers gave the following answers.

> *…It wouldn't have made any difference…nah I needed that cash…*

> *…thinking back to the way I was I probably would have taken it out once because it was desperately needed…*

Nevertheless, it is only appropriate that payday loan consumers should be given adequate access to comparison rates and APRs. With payday loans now covered by the Uniform Consumer Credit Code APRs should, in theory, be provided to all consumers. While it is unlikely this will prevent first loans it may well have some incremental effect on repeat borrowing.

8.4.2 Opinion of costs

Interview participants were unanimous in considering charges on payday loans to be too high. Although consumers generally do not understand the costs in terms of comparison rates they are aware that they pay dearly for access to credit.

> *…their interest rate was too high. I think it was four hundred and I was paying back about a hundred and sixty. And I thought nah it's getting too high I can't afford it … I didn't think it was going to be that much of an interest rate. It was a kick in the butt…*

> *…they work things out and explain it to you in a nice way and you like it. But when you stop and think about it, it's a bit much…*

> *…I think it's a good money earner for them. What they do the banks don't…*

There are some consumers who simply accept that with few credit alternatives they are forced to bear high charges.

Several interview participants accepted that as payday loans were the only credit option they could access, paying high charges was inevitable, though not desirable.

> *…to be honest with you I am probably just realistic…so looking at the charges with getting a couple of hundred, yes I'd prefer it lower. But I'm the one that needs it and they're prepared to give it to me. I'm prepared to pay them…*

> *…I sort of just, oh well that's it. I need the money so I've got to pay it…*

However for other interview participants the charges were a source of considerable frustration, particularly with consumers using payday loans on a regular or semi-regular basis. Several participants described feelings of frustration with charges on the days payment was made.

> *…I'm thinking that sixty-two dollars really, I should be, you know, it could be going on something. And now it's coming out and going to them, you know. And I'm thinking I want that back in me bank book…*

…It's good in one way, to get the money. But when you've got to pay it back with that amount of interest it hurts. It really hurts…

While customer service and design of the financial product were popular with interview participants, cost remained the major complaint. One consumer put it quite plainly.

…the only drawback with it is the amount you pay back…

8.5 Other Credit Providers

Some consumers who participated in interviews had also used other forms of credit. Several had used pawnbrokers or Cash Converters, while others currently had credit cards or had had some experience with them in the past. All consumers had had at least some interaction with major banks.

The following sections provide some insight into how payday loan consumers view these other potential sources of credit. In doing so they demonstrate why neither credit cards nor pawnbrokers can be considered a substitute for payday loans.

8.5.1 Pawnbrokers

Consumers left little doubt that they consider payday lenders to be a superior option to pawnbrokers. Generally consumers considered payday lenders to be a tier above pawnbrokers, and several consumers who had used a payday lender stated they would find approaching a pawnbroker demoralising.

Others who had used both pawnbrokers and payday lenders considered payday lenders to be a far more 'professional' and dignified means of accessing credit. Payday lenders were seen to have less of the stigma of desperation and poverty many associated with pawnbrokers.

…they don't make you feel uncomfortable when you're dealing with money you know and I suppose I'm relating to pawnbrokers or whatever where you feel that you're going in there and begging…

…you pay that much or more at Cash Converters, or anything. And maybe it's easier than lugging things in and out. And they know, in Cash Converters, that you're desperate. And they know they can hit you with sort of anything…

There were some general points that emerged from interview participants who had used both pawnbrokers and payday lenders. These were:

- Pawnbrokers often paid well below the value of goods;
- The negotiation involved in pawning transactions was felt to be demeaning; and
- It was too easy to forget about pawned goods which led to the loss of items

Pawnbrokers were clearly seen as the lender of last resort. Payday lenders, on the other hand, were the lenders of second-to-last resort.

8.5.2 Loans from family and friends

That payday loans offered some sense of independence for borrowers came through strongly in interviews. Rather than the obligations, loss of privacy and potential strain on relationships of loans from family and friends, a payday loan offered some consumers the feeling that they were responsible and in charge of their finances.

There are some consumers who use payday loans precisely because the option of loans from family and friends is not available. For those who have moved from overseas and interstate this can often be a factor. One consumer gave just such reasons.

> *…It just comes in handy, especially if you've got no one you can borrow money off. Cause all my family lives in Queensland so I've got no one down here…*

For those who could borrow from family and friends however, the payday loan was often seen as a means of preserving dignity and independence.

> *…this is sort of a form of independence. It's just the way I am. I would rather pay the $80 charges than go and ask my mother for handouts. We all have different levels of pride don't we…*

8.5.3 Credit Cards

Low-income consumers exhibit a deep suspicion of credit cards. Generally they were not favoured because repayment dates were imprecise and they were perceived to be difficult to manage.

Put simply, many low-income consumers see a credit card as a never-ending debt. This is significant, because an aspect of payday loans greatly appreciated by consumers is that the loan is finite and for a fixed sum.

Consumers were also uncomfortable with the limits allocated to credit cards, which were thought to be unrealistically high for those on low incomes.

> *…I only wanted a thousand dollar credit card from the ANZ and they gave me a three thousand dollar one. And it sort of has got me in the shit a bit. You know I tend to sort of you know put money in and take it out and then I've overdrawn on it and done stupid things…I just don't like credit cards…*

Other consumers who did not have a credit card strongly suspected they were a fast track to financial disaster.

> *…No I wouldn't bother, not with the debts that you get with those. No thank you. I steer clear of credit cards. No one can talk me into that…*

Payday loans were seen as a better way to manage money than credit cards because they were for a fixed sum over a short period. Credit cards were perceived to be unmanageable and most consumers saw them as a dangerous temptation to mount sizeable debts that they would be unable to repay.

8.5.4 Banks

It will come as no great surprise that payday loan consumers both dislike and distrust major banks. The reasons are much the same as those that are commonly heard across the community: hidden charges, high fees, incomprehensible documentation and lack of service.

One consumer put it rather bluntly in comparing the banks to payday lenders.

> *…It's like walking into a bank except they're friendlier…when I said it's like a bank it is actually better because you get service…*

That a group of consumers who have been for the most part actively discouraged by major banks, should hold them in such low regard is not at all remarkable. The point need not be laboured further here.[198]

Some consumers had attempted to get assistance from banks, but the experience was inevitably disappointing.

> *…when I went in there, they told me that I couldn't get loans like that. Banks wouldn't do that…*

However it is of considerably more interest that several consumers expressed the opinion that banks should offer a financial product similar to payday loans.

> *…banks would be better but on a short-term basis, yeah. I mean I'm surprised they don't do it. Obviously it would be better…but most of them it's $4000 minimum and a lot of people don't want $4000. It's just too tempting for them you know…*

Such comments reveal just how irrelevant to low-income consumers the financial products offered by major banks have become.

8.6 Summary: Why Payday loans?

The following sections make it clear by comparison that there are a number of aspects of the payday loan financial product that appeal to consumers. This is not to say that consumers choose payday loans.

The idea, put forward by the industry to the Queensland inquiry, that a consumer would choose to use payday loans simply because of the convenience and lack of paperwork is certainly not supported by the findings.[199]

Payday loan consumers, for one reason or another, are invariably vulnerable consumers who have virtually no market choice in terms of credit. Those using payday loans may think convenience and lack of paperwork are good things, but they would not have chosen to use the service for those reasons.

Nevertheless, it is important to understand what consumers do like about payday loans.

One aspect of payday loans of which consumers clearly approve of is the design of the financial product itself.

The sheer simplicity of payday loans makes them extremely attractive to consumers: a small sum with a definite amount to be paid back within a short period of time, and on a set date.

Payday loans are easier to comprehend than either pawning transactions or credit cards. Moreover the size and periods of the loans are wholly appropriate to how those on low-incomes organise their finances.

Consumers also greatly appreciate the independence, privacy and self-esteem that comes from having access to credit in the financial services marketplace. Payday loans are not charity but commercial transactions, and this is important in fostering feelings of financial and social inclusion.

Payday lenders are also perceived as offering a more 'professional' service than pawnbrokers and without the social stigma.

The major drawback identified by consumers is the cost of the loans. Consumers are aware that payday loans are an expensive form of credit. However payday loan consumers lack the market power to access cheaper alternatives. Therefore they are forced to bear charges that are the highest in the credit marketplace.

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198 For a detailed discussion of issues surrounding banking services see Connolly & Hajaj 2000, above note 98.
199 Queensland Office of Fair Trading 2000, above note 42, p. 15.

There is no doubt that there is complete market failure in the short-term credit sector. Despite an obvious market, competition has failed to provide low-income consumers with short-term credit at rates comparable to those for more affluent consumers. Low-income consumers have identified the sort of financial product they require. It is a matter of social equity that it be provided to them at a fair and just price.

9. Payday Lending: Policy Recommendations

In a study of alternative financial services in Canada, Professor Iain Ramsay likened the high cost of credit paid by vulnerable consumers to a form of regressive taxation. Professor Ramsay identified 2 major public policy challenges arising from the rapid expansion of the alternative financial sector:

1. To ensure the needs of vulnerable consumers are met in a less costly manner; and
2. To regulate abusive practices effectively.[200]

Policy makers in Australia are currently facing these same challenges in relation to the payday lending industry.

It is clear that there is a significant, and growing, demand for credit from low-income consumers. However payday lending can hardly been seen as an appropriate solution to this demand. Vulnerable consumers are being charged exorbitant rates, far in excess of the sources of credit accessed by middle-income consumers.

This final chapter makes 5 recommendations with a view to making credit available to vulnerable consumers at a cost comparable to those enjoyed by other consumers.

However it firstly needs to be stated that demand for short-term credit from low-income consumers ultimately stems from inadequate levels of income. Low-income consumers utilise credit to make ends meet, a task becoming increasingly difficult as incomes remain static or decline in the face of rising living costs.

The community sector has repeatedly advocated raising welfare payments to levels enabling at least a basic standard of living. Likewise the ACTU Living Wage 2002 campaign draws attention to the fact that many working Australians increasingly struggle to survive while in employment (the so called "working poor").

This report can only reiterate these demands for a more equitable and equal society, as ultimately payday lending is only one unpleasant consequence of an increasingly unequal and divided society.[201]

Nevertheless we make the following recommendations to immediately address the current inequity in the short-term credit market. Broadly, these recommendations are:

1. Ensuring the integrity of the 48% interest rate cap in relation to payday loans in Victoria as well as ensuring that a 48% interest rate cap (including a "true cap of credit reform") is implemented nationally;
2. As part of their social obligation, the entry of major financial providers to the short-term credit market and the development of a credit product tailored to the needs of low-income consumers. Increased flexibility in the delivery of Centrelink Advance Payments currently administered by the Commonwealth Department of Family and Community Services;
3. Expanding the agenda of No Interest Loan Schemes (NILS) to include items such as car repairs, car registration and utility bills; and
4. More flexible payment options for car registration.

Recommendation 1: Apply 48% Interest Rate Cap

The state/territory jurisdictions of Victoria, New South Wales and the Australian Capital Territory currently have a 48% interest rate cap on consumer lending. An interest rate cap is desirable as it protects vulnerable consumers from exploitation through the dangers of high priced credit.

[200] Ramsay 2000, above note 26, p. 40.
[201] Field, above note 44 at p 36 .

However whether the 48% interest rate cap applies to payday lending transactions in Victoria is presently unclear. The situation has been clarified in New South Wales by specific legislation stipulating that a maximum annual percentage interest rate (48%) is to be calculated on the basis of interest and all credit fees and charges under the contract.[202]

Similar legislation should be enacted in Victoria to afford vulnerable consumers full legislative protection against the present excessive interest charged across the payday lending industry. Any legislation would need to be drafted in such a way as to be completely unambiguous about the fees and charges to be included in calculations of interest. This is necessary as the industry has demonstrated ceaseless innovation in avoiding any limitation on charges to date, and is likely to continue to search for potential loopholes in regulation.

It should also be added that it is important not only that the 48% interest rate cap be clearly defined and applied to payday lending transactions, but also that it be enforced.

There are therefore 2 important components to applying a 48% interest rate cap on payday lending transactions. These are:

1. Enacting legislation for the purpose of limiting all fees and charges in a payday lending transaction to not exceed an actual annualised percentage interest rate of 48%; and
2. The monitoring of payday lenders by Consumer Affairs Victoria to ensure compliance with the legislation's provisions.

This Report recommends that legislation clarifying the application of Victoria's 48% interest rate cap to payday loans be enacted, and that such legislation be enforced by Consumer Affairs Victoria.

Credit legislation in Australia is, for the large part, uniform and approached on a national basis. For the purposes of uniformity, and in the interests of national consumer protection, a 48% interest rate cap (which includes all fees and charges) should be implemented throughout Australia.

It is recommended that a 48% interest rate cap be made uniform throughout Australia as should be regulation to ensure that the true cost of credit is no greater than the interest rate cap. Monitoring by state-based consumer affairs agencies should be undertaken to ensure compliance with the cap.

Recommendation 2: Entry of major financial institutions into the short-term credit market

There is a growing consensus that Australia's major banking institutions have a social obligation to the wider community.[203] How these social obligations might be fulfilled remains the subject of vigorous discussion. It is beyond the scope of this report to recommend how banks might be compelled or induced to fulfil their social obligations. However the major banks are well positioned to offer low-income and vulnerable consumers short-term credit for sums under $2000.

Much discussion to date has focussed upon the provision of minimum banking services, with particular emphasis on the provision of low-cost basic accounts tailored to meet the needs of those disadvantaged by high transaction costs. The provision of a basic loan product should also be included in these discussions.

Currently personal loans offered by banks (seldom for sums of less than $4000 or for periods of less than 12 months), are unsuitable for low-income consumers requiring credit. Similarly, credit cards are undesirable, unobtainable or inadvisable for many vulnerable consumers. It is the banks' failure to cater for these consumers that, in part, has facilitated the emergence of payday lending.

[202] *Consumer Credit (New South Wales) Amendment (Pay Day Lenders) Act* 2001
[203] Connolly & Hajaj 2000, above note 98, p. 36.

Major retail banks should offer low-income consumers a financial product broadly similar to a payday loan at an interest rate close to the current personal loan interest rate (including charges). This would be a short-term loan of between $100 and $2000 for up to 2 months. In our view, such a product could be commercially viable given the obvious economies of scale and risk levels.

By providing short-term small loans, banks would fulfil a social obligation by providing credit to sectors of the community currently excluded from mainstream credit provision. This would engender a broader sense of financial and social inclusion and assist many vulnerable consumers to build up an improved credit rating.

Additionally the provision of such a product is commercially attractive. The reasons for this are indicated elsewhere in this report, but briefly they are that:

- There is a sizeable market in Australia for short-term small loans; and
- Default rates on small loans are low, meaning risk is minimal.

We believe a Low Interest Loan Scheme would best be operated by a partnership between a bank or banks, government and either one or several community organisations. State government funding support, either directly or through a fund such as the Community Support Fund, would be appropriate.

The venture would compete in the commercial marketplace, while offering a financial product with a significantly lower rate of interest than that now available.

Importantly, it would need to treat consumers as 'customers'. Any initiative perceived by those presently using payday loans to be a form of charity would risk undermining the sense of independence and financial inclusion many currently experience and highly value.

This Report recommends further investigation be undertaken regarding facilitating and supporting a community/private/public sector partnership low-interest loan scheme, with a view to creating a financial product tailored to the needs of vulnerable consumers currently using payday loans.

Recommendation 3: Increased flexibility of Centrelink Advance Payments

Individuals in receipt of a range of income support payments are eligible to receive one advance payment of $500 per year from Centrelink. The payment can create additional hardship, as already limited incomes are further reduced until such time as the advance is repaid.

The Centrelink Advance Payment was used by 20% of payday loan consumers surveyed. Consumers tend to access the advance first, and then use payday loans until they become eligible for a further advance.

The current rigidity of the Advance Payment is problematic. It is highly likely that some consumers would not use payday loans if there were a greater degree of flexibility in the administration of the advance. It would seem reasonable and desirable if consumers in receipt of income support could receive smaller advances over shorter periods of time. Upon repayment they should then become eligible for a further advance, perhaps with the limitation of a fortnight's 'cooling off' period.

Obviously this does not deal with the problem of advance repayments reducing chronically low-incomes. However it would provide a more flexible means of attaining additional cash flow to deal with unforseen and unexpected expenses without acquiring a 13 week $500 debt. Increased flexibility would enable some consumers to manage advance payments of smaller sums and periods, rather than resorting to payday loans.

This Report recommends that the Department of Family and Community Services introduce greater flexibility to the delivery of the Centrelink Advance Payments.

Recommendation 4: Expansion of agenda of No Interest Loan Schemes (NILS)

No Interest Loan Schemes (NILS) are operated by community organisations throughout Melbourne and in some Victorian regional and rural centres. They provide small interest free loans (usually less than $800) to low income earners, generally those receiving some form of income support. Loans are mostly provided for the purchase of household goods and other essential items.[204]

NILS represent an important and much needed innovation by the community sector to provide credit to those on low incomes. Nevertheless the limitation of loans to household goods means few payday loan consumers, who predominantly require credit for living expenses and bills, presently qualify.

NILS schemes in operation should give consideration to expanding loans to cover needs such as car repairs, car registration, utility bills and school fees. While it is unlikely that all payday loan consumers would be attracted to NILS as an alternative, the 38% of payday loan consumers on income support might be able to reduce their reliance on payday loans through this means.

There is also a need for greater public information on NILS schemes. Very few payday loan consumers are currently aware of NILS.

The additional expenditure and infrastructure involved in the expansion of NILS schemes would benefit from State Government support.

This Report recommends expanding the agenda of existing NILS schemes and additional State Government support for these initiatives.

Recommendation 5: Flexible Payment Options for Car Registration

One targeted measure to reduce demand for short-term credit would be the introduction of more flexible car registration payment options. Car registration represents a substantial expense for low-income earners, who frequently have insufficient income to meet this expense out of usual finances.

VicRoads should introduce more flexible payment options, for example four payments over 2 months from the date of previous registration expiring. This would reduce recourse to payday loans to meet this expense.

This Report recommends that more flexible payment options for car registration be offered in Victoria

Conclusion

The cost of credit offered to vulnerable consumers by payday lenders is clearly unconscionable. An effective policy response requires that consumers be protected from exploitative credit. In the short-term credit sector 'market forces' have failed to provide consumers with a competitively priced financial product. Legislative

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[204] For more discussion of NILS see Margaret Roberts 2000, *Interest-Free Loans: A Review Commissioned by the Ian Potter Foundation*, Ian Potter Foundation: Melbourne; Australia Street Company 1999, *Review of No Interest Loan Schemes*, NSW Department of Fair Trading: Sydney. See also Hahn 1999, above note 109. Some NILS do provide loans for a wider range of needs including car registration, dental costs and debt consolidation, see Australian Street Company 1999; also PDL I 003, Interview with Kit Hauptmann, Jill Com & Brian Harvey, Financial Counselling Services Southern, 9 November 2001.

initiatives are necessary to restore equilibrium in a distorted sector and regulate interest rates soaring above those in other segments of the financial services marketplace.

However it is insufficient to only impose regulation upon the worst abuses. Policy responses to the payday lending phenomena require a multifaceted approach that will also provide viable credit alternatives to consumers. The provision of a financial product tailored to the needs of low-income and vulnerable consumers offered by mainstream banking institutions in partnership with the community sector and government is critical.

Appendix A: Payday Lending Survey

Section A

Q. 1 DID YOU VISIT (NAME BUSINESS) TODAY TO? (Read Out)

- ❑ A] Get a short-term loan
- ❑ B] Repay a loan
- ❑ C] Other

A] or B] continue. If C] specify service used and terminate survey

Q. 2 HOW MUCH WAS YOUR LOAN FOR?

Q. 3 HOW LONG DID YOU GET THE LOAN FOR?

Q. 4 HOW MUCH IS THE FEE FOR THAT LOAN?

Q. 5 AND WHAT IS THE PURPOSE OF YOUR LOAN?

Q. 6 IS THIS THE FIRST TIME YOU HAVE GOT A PAYDAY LOAN?
If no continue, if yes go to Q. 10

Q. 7 HOW MANY LOANS HAVE YOU HAD IN THE PAST TWELVE MONTHS, APART FROM TODAY'S?

Q. 8 AND WERE THEY ALL FROM THE SAME PLACE?
If no continue, if yes go to Q. 10

Q. 9 HOW MANY OTHER PAYDAY LENDERS HAVE YOU USED?

Q. 10 HAVE YOU USED ANY OF THESE FORMS OF CREDIT OVER THE PAST TWELVE MONTHS? (Read out)

- ❑ Credit Card
- ❑ Bank or Co-op Loan
- ❑ Centrelink Advance Payment
- ❑ Pawnbroker
- ❑ Finance Company
- ❑ Loan from family or friends

Section B: Demographics

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1. GENDER
   - ❑ Male
   - ❑ Female

2. AGE (Read out)
   And are you?
- ❑ Under 18
- ❑ 18-25
- ❑ 26-35
- ❑ 36-45
- ❑ 46-55
- ❑ 56-65
- ❑ Over 65

3. MARITAL STATUS
   A] AND ARE YOU?
- ❑ Single
- ❑ Married/Defacto
- ❑ Separated/Divorced
- ❑ Widowed

   B] AND DO YOU HAVE ANY CHILDREN LIVING WITH YOU?

   C] (IF YES) HOW MANY?

4. INCOME
   AND WHAT IS YOUR USUAL WEEKLY INCOME?

5. AND IS THAT FROM? (Read out)
   - ❑ Full-time work
   - ❑ Part-time work
   - ❑ Casual work
   - ❑ Centrelink payment (specify)
   - ❑ Other (specify)

6. HOUSEHOLD
   A] AND IS YOUR ACCOMMODATION? (Read out)
   - ❑ Private Rental
   - ❑ Public Rental
   - ❑ Own Home
   - ❑ Temporary Accommodation
   - ❑ Other (specify)

   B] AND HAVE YOU BEEN THERE FOR OVER A YEAR?

7. AND WHAT SUBURB DO YOU LIVE IN?

8. EDUCATION
A] WHAT YEAR WERE YOU IN WHEN LEFT SCHOOL?

Grade (specify)

B] AND HAVE YOU DONE ANY COURSES SINCE THEN?

9. A] WHERE WERE YOU BORN? (Don't read out)

- ❑ Australia
- ❑ United Kingdom
- ❑ Italy
- ❑ Greece
- ❑ Vietnam
- ❑ New Zealand
- ❑ Other (specify)

B] WHAT LANGUAGE DO YOU SPEAK AT HOME? (Don't read out)

- ❑ English
- ❑ Italian
- ❑ Greek
- ❑ Cantonese
- ❑ Vietnamese
- ❑ Arabic
- ❑ Macedonian
- ❑ German
- ❑ Other (specify)

Survey End

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