

## JOINT CONSUMER SUBMISSION

regarding

The Ministerial Council on Consumer Affairs' Discussion Paper on Long Term Regulation of Fringe Credit Providers.

This submission has been prepared by:

Consumer Credit Legal Centre (NSW) Inc.  
Consumer Credit Legal Service Inc. (Vic)  
Consumer Law Centre of the ACT  
Consumer Law Centre Victoria

It has been endorsed by the Consumers' Federation of Australia, together with the following member agencies:

Australian Financial Counselling & Credit Reform Association Inc.  
Care Inc. Financial Counselling Service (ACT)  
Financial and Consumer Rights Council (Vic)  
Queensland Consumers' Association

We are aware of, and wish to endorse, the independent submission by Ms Therese Wilson, Griffith University.

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We welcome the Ministerial Council on Consumer Affairs' Discussion Paper on Long Term Regulation of Fringe Credit Providers. While we support the proposals for regulatory intervention, we believe that any long term effective regulation of fringe lending must include a reasonable interest rate cap (that includes fees in its calculation).

## Introduction

Fringe lending and the activities of fringe credit providers have been correctly recognised as posing unique and unreasonable dangers to consumers.

Fringe credit providers offer credit at exorbitant cost to consumers who are denied access to mainstream credit, and by so doing usually exacerbate the problems – financial and otherwise – already experienced by those consumers. Fringe credit is generally obtained to pay for day to day living expenses, including bills<sup>1</sup>, suggesting an inability by fringe credit borrowers to meet existing financial commitments, let alone the substantial additional costs associated with this type of credit.

Fringe credit providers often add to the unconscionable nature of their products by actively seeking to avoid consumer protection legislation including the Consumer Credit Code (the **Code**), and by other means including the taking of blackmail securities and/or demanding direct debit facilities.

In this context we are disappointed that the need for government intervention appears to have been primarily assessed by reference to National Competition Policy.

Fringe credit providers engage in an invidious form of exploitation, relying on the existing misfortune of their borrowers. Those borrowers are typically low income and vulnerable consumers, and as is noted in the Discussion Paper, “a large proportion of fringe credit borrowers have little choice but to use fringe credit products on the terms and conditions offered by credit providers”<sup>2</sup>. Reliance on competition as an effective regulator at this end of the consumer credit market is clearly inappropriate, and in our view will not adequately protect vulnerable consumers from continued exploitation.

The focus of government and regulators must be on providing effective consumer protection against patently undesirable practices and products. In our view this involves prohibiting the excessive cost of fringe credit through a national cap on credit.

It is acknowledged that such prohibition may force some fringe credit providers out of the market, and may limit the availability of credit to low income and vulnerable consumers due to the reluctance of mainstream credit providers to service those consumers.

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<sup>1</sup> Dean Wilson, Consumer Law Centre Victoria, *Payday Lending in Victoria – A research report*, July 2002, page 10.

<sup>2</sup> Discussion Paper, page 19.

This does not, however, allow for the conclusion that fringe credit providers, operating as they currently do, are a necessary component of the market. Rather, the legitimate needs of low income and vulnerable consumers to access credit that is safe, and that is offered on reasonable terms and at a reasonable cost, must be met by alternative means. The importance of identifying and implementing those alternative means cannot be underestimated.

To abandon those consumers who are unable to access mainstream credit to the unreasonable dangers of fringe credit is to literally abandon them to the sharks.

## 2. Industry Overview - Discussion Points 1-5

### 1. *Do you agree with the description of the fringe credit market?*

Yes, we would generally agree with the description of the fringe lending market. We consider there are three defining characteristics of fringe credit, the existence of any one of which arguably brings a loan under the umbrella of fringe credit:

- high cost;
- short term;
- relatively small amounts.

There is no doubt that payday lending, which incorporates all three elements, best illustrates many of the issues that justify the current concerns about fringe lending. It is important, however, that the many other forms of fringe lending be appropriately recognised in formulating a regulatory response, as we otherwise risk encouraging further exploitation of vulnerable consumers by unscrupulous operators.

With this in mind, we would add the following observations.

1) It would be a mistake to stereotype the fringe lending market based on the well-documented practices of existing fringe credit providers.

The fringe credit market is constantly reinventing itself, with new credit providers regularly entering the market and often offering different forms of fringe credit. This characteristic demonstrates the need for a robust approach to regulation of the market.

The present regulatory problems provide excellent case studies of how fringe lenders have adapted to exploit “loopholes” in the Code. Section 7 of the Code provides for a number of exemptions, including:

- **Short term loans.** Pay day lenders entered the market to lend with effective interest rates of around a 1000% p.a. No cap on the exorbitant fees has been introduced to date except in New South Wales. To avoid the cap in New South Wales, a particularly inventive payday lender became a finance broker and charged the exorbitant fees anyway.

- **Bill Facilities/Bills of Exchange.** A fringe lender has now entered the fringe lending market who lends for personal purposes and claims that the Code does not apply as there is an exemption for bill facilities.
- **Pawnbrokers.** Our casework experience indicates that a number of pawnbrokers regularly lend money that should be regulated by the Code (yet the pawnbrokers argue it is not regulated as they are pawnbrokers).

We would encourage the Ministerial Council to take heed of past experience and recognise that to take effective long term action for effective consumer protection it is necessary to introduce an effective interest rate cap and an anti-avoidance provision. What is clear since 1996 is that fringe lenders will adapt as necessary to exploit vulnerable consumers.

2) Our casework experience clearly indicates that the fringe credit market is not necessarily a short term loan market. We are seeing a range of loans where the term exceeds 12 months.

3) Lending for a fixed fee (or fees) is a characteristic of payday loans, whereas other forms of fringe credit tend to utilise a combination of fees and interest charges. Similarly, demand for repayment by direct debit is most consistently made by payday lenders, rather than by all fringe credit providers.

2. *Can you supply information/data on the fringe credit market?*

The CLCV research report, *Payday Lending in Victoria*<sup>3</sup> is one of the few pieces of research into this area undertaken in Australia.

Our comments are however based more firmly in the casework experiences of the various contributors, who assist fringe credit borrowers in various ways.

Financial Counselling agencies are often called upon to assist those borrowers who are suffering particular financial hardship. Commonly, consumers seeking to enter into bankruptcy have one or more loans with fringe credit providers, and often relate that these loans were entered into in a last ditch effort to stave off the inevitable. In fact many of these consumers may have been able to avoid bankruptcy had they sought assistance prior to obtaining such credit, particularly where the loan was initially obtained to pay utility bills, in respect of which arrangements to accommodate financial hardship are usually available.

A common theme is lack of awareness of options, including hardship relief offered for essential services, the existence of financial counselling services and so on. Compounding this issue is a relatively new tactic adopted by some debt collectors of requiring that a consumer pay off a debt by obtaining credit, whether by paying the debt on a credit card or obtaining a new loan, which will by definition almost inevitably be fringe credit.

See for example Case Study A (below).

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<sup>3</sup> *Payday Lending in Victoria – A research report*, above, ref. 1.

In our experience, there are four distinct types of fringe lending:

- Payday Loans. This type of lending is clearly described in the CLCV report.
- Blackmail Securities Loans. These loans are distinguished by:
  - high interest rates;
  - high set up costs;
  - excessive churning/refinancing;
  - high default costs; and
  - the use of excessive/blackmail security, including security over household goods and/or vehicles.

Consumer agencies often receive requests for assistance from fringe credit borrowers who have entered into loans involving blackmail securities. Those borrowers are often subjected to undue harassment and threats of repossession (although instances of repossession are extremely rare), or are reluctant to enter into bankruptcy as they have been told they will still risk losing their household goods. It is worth noting that CCLS (Vic) acted on behalf of a number of such consumers in pursuing actions in the Victorian Civil and Administrative Tribunal (VCAT) arguing that these mortgages are unjust pursuant to section 70 of the Code. All such cases have settled, and the actions have had no impact on the activities of the relevant fringe credit provider.

In addition to the problem of blackmail securities there is the exorbitant costs of refinancing the loan. Our casework experience is that often the consumer has no hope of paying out the original loan in the original term. The lender then refinances the outstanding loan into a new loan. Given that a major part of the effective interest rate is the set up costs (around \$350 for loans of \$500 to \$5000) this leads to exploitative lending at its worst. The consumer is effectively caught in a debt trap that will inevitably be beyond their means to repay. Again section 70 is of little assistance - the over-commitment is not clear as existing debts are being refinanced and the unconscionable charges are spread over interest and fees.

Any regulation of fringe lending must deal with this type of excessive refinancing that bolsters the cost of credit. We would again state that the only effective mechanism is to have a uniform 48% p.a. cap that includes fees in its calculation. The cap would also need to encompass further refinancing.

See also Case Study B (below).

- High Cost Fringe Loans which avoid the Consumer Credit Code. These loans do not comply with the Code, and lenders rely on a range of reasons as to why the Code does not apply.

This is a burgeoning area. Lenders are increasingly sophisticated in evading or attempting to avoid compliance with the Code. We have identified three of the primary avoidance methods utilised by fringe credit providers:

(a) *Business Purpose Exemption* - By requiring that the borrower sign a Business Purpose Declaration, lenders create a presumption that the Code does not apply.<sup>4</sup> While a debtor can seek to rebut this presumption, simply shifting the burden of proof is often sufficient to deny debtors the rights and remedies to which they are otherwise entitled. Further, if the lender utilises an intermediary to obtain the Declaration (such as a solicitor), then even if the Declaration is found to be ineffective, the lender's "belief" as to the purpose for which the credit was obtained is likely to ensure that the loan will be considered unregulated.<sup>5</sup>

See also Case Study C (below).

(b) *Bill Facility Exemption* – At least one major fringe credit provider is utilising section 7(5) to avoid regulation by the Code. The terms of these transactions involve interest of 15% per month (180% p.a), with security obtained over the debtor's car. To our knowledge the Bill of Exchange securing the Bill Facility is never negotiated, however it is unlikely that this will affect the transaction given the wide definition of bills of exchange in the relevant legislation.

Exploitation of this exemption is likely to increase considerably as it is an obvious "loophole". We consider urgent amendment of the Code is required to either remove this exemption (ie. all bills for personal purposes are regulated – it is our understanding that there are very few as most bills are commercial bills used by companies), or to require that bills are negotiated through a bank/ADI (as is usually the case).

See also Case Study D (below).

(c) *Pawnbroker Exemption* – Pawnbrokers are regularly acting as fringe lenders and (knowingly or unknowingly) failing to comply with the Code.

See also Case Study E (below).

- There are also a number of credit providers which are not aware of the Code or which simply choose to ignore the Code, for example, lenders which provide:
- small loans provided by finance/mortgage brokers to complete the primary loan;
  - small loans provided by motor car traders to complete the purchase of a car; and
  - consumer rental agreements that include a right or option to purchase the goods (often verbal), which the Code deems to be a provision of regulated credit.<sup>6</sup> See case study F (below).

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<sup>4</sup> Consumer Credit Code – section 11.

<sup>5</sup> Eg. *Neuendorf v Rengay Nominees P/L & Anor*, (unreported) Victorian Civil and Administrative Tribunal, 3 September 2002.

<sup>6</sup> Consumer Credit Code, section 10.

It must be stated that the incidence of lenders ignoring the Code is a growing area. Many fringe lenders are well aware that the chances of “getting caught” are low because:

- Their customers are poorly educated low income people who have little access to justice. These consumers often feel it is their fault they have had to go to “loan shark” and are reluctant to complain. Alternatively, the consumer is too scared to complain.
- Lenders are well aware of the lack of enforcement of the Code by Consumer Affairs Agencies around Australia.
- Even if the lender is “caught” and the consumer finds legal assistance and the matters goes to Court, the lender is only likely to lose the interest on the loan. If this only happens every now and then, the fringe lender can easily cope with the loss.

Effective regulation of fringe lending must also deal with those fringe lenders who ignore the law. With no prosecutions to date by Consumer Affairs Agencies around Australia it is clear that the Code must be amended to allow consumers to bring “class actions” or make the civil penalty provisions “self activating”.

3. *Are there any other sources of information/data on the fringe credit market?*

In relation to the Australian market, not that we are aware of.

4. *Are borrowers able to substitute short term fringe credit products with longer term mainstream loans such as personal loans or credit cards?*

In a very large proportion of cases, no. Fringe credit borrowers are typically aware that they are entering into high cost transactions, but have no choice available to them as they are denied access to mainstream credit products.

5. *Do mainstream credit providers provide similar products to fringe credit providers? Are these products available, or commonly used, by the consumers of fringe credit products?*

On the basis that one of the defining characteristics of fringe credit is high cost, then it is clear that at least one mainstream credit provider offers similar products.

It is our understanding that GE Capital Finance offers some products at interest rates of around 30% per annum (plus fees and charges). Having regard to the individual financial position of those borrowers who obtain these products, we believe the cost to be excessive and unreasonable. As noted in relation to Discussion Point 2 above, the protections offered by sections 70 and 72 of the Code actually provide little assistance to individual consumers, and no protection at a systemic level. GE Capital Finance has recently received a great deal of media attention where a number of consumers have accused GE of unconscionable practices, alleging:

- Excessive interest
- Forced insurance selling
- Unconscionable default fees
- Excessive refinancing of loans.

### 3.1 Industry Problems - Discussion Points 6-7

6. *What are your experiences with consumer problems in the fringe market?*

See above in relation to Discussion Point 2.

See attached Case Studies.

7. *Are there other consumer problems which should be addressed?*

See above in relation to Discussion Points 2 and 6.

We consider there are a number of consumer problems which also need to be addressed (some of these problems have been mentioned above and are mentioned again for the sake of completeness):

(a) **Code avoidance as a systemic issue.** Although many problems have been discussed at Discussion Point 2 above we feel strongly that these are only the problems obvious now and inevitably there will be ongoing Code avoidance (exploiting other “loopholes”). Based on past experience and our casework experience, any regulatory solution that does not involve a uniform cap and a robust anti-avoidance provision with severe penalties (and active enforcement) will leave the most vulnerable consumers at the mercy of loan sharks.<sup>7</sup>

(b) **Excessive refinancing/churning.** This is definitely a systemic issue. It is clear from our casework experience that this type of lending is very lucrative for fringe lenders as it compounds already excessive fees and interest. For vulnerable consumers, this debt trap leads inevitably to bankruptcy as the debt climbs with added fees and default fees until the consumer is completely overcommitted. This occurs with all types of fringe lending that we have encountered and is extremely exploitative. Excessive refinancing exemplifies why an interest rate/fee cap is absolutely necessary. For example, many social security recipients can manage a credit card with a limit of \$500. However, this is not possible with fringe lenders as the effective interest rate (including fees) will usually exceed 100% p.a. Even the most diligent consumer could not manage a debt escalating at this rate. The situation is even more dire for low income consumers, the majority of whose income is committed to basic living expenses such as rent and food.

In addition to a uniform cap, it is necessary to clearly legislate that the cap applies to refinancing within the same calendar year.

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<sup>7</sup> Loan sharks being defined as lenders who lend at exorbitant rates.

(c) **Rental Agreements.** There are a number of lenders who state they are renting goods when in fact the consumer is assured that they will own the goods at the end of the agreement. The consumers sign a rental agreement but are clearly told that they will own the goods. The goods are usually second hand with little or no value except to the owner. The consumers are deprived of the main protection under the Code and are charged an effective interest rate in excess of 100% p.a.

Rental agreements are really another form of Code “loophole”, as the consumer lease provisions are far less stringent than the provisions covering loans. The consumer will find it almost impossible to prove that the agreement was a sale of goods by instalments as they have often signed a rental agreement.

This is really just another form of fringe lending using blackmail securities (the rented goods) and charging exorbitant rates.

It is our view – a view that has been expressed before<sup>8</sup> – that the only means of ensuring adequate protection for consumers is to bring regulation of consumer leases in line with other consumer credit products.

Some lenders have sought to exploit an even greater loop-hole by providing credit by way of a sale by instalments. This is particularly prominent in relation to real estate (often referred to as sale on vendor terms), but at least one lender recently developed a product that essentially involved purchase of a debtor’s goods and sale of those goods back to the debtor by instalments. The lender asserted that this transaction was not regulated by the Code, but on its face it appeared little different to other forms of fringe credit utilising blackmail securities. The Code must be amended to ensure that transactions of this type are clearly regulated.

In addition, consumer advocates have been raising concerns for some time regarding debt collection practices and undue harassment.<sup>9</sup> The use of blackmail securities highlights some of these issues in the particular context of fringe lending, however, given the type of lenders engaged in fringe lending it is our experience that debt collection methods are often particularly bad at this end of the market. Examples of extreme misconduct such as that revealed in *State of Queensland v Ward & Anor*<sup>10</sup> are rare, however the debt collection activities of fringe credit providers is worthy of particular attention.

### **3.2 Reasons for Government Intervention - Discussion Point 8**

8. *Do you agree that the main market failure in the fringe credit market is based on information asymmetry?*

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<sup>8</sup> Joint consumer-based submission to the NCP Review of the UCCC, 3 May 2002.

<sup>9</sup> See for example “Selling Their Customers Out: Consumer Problems with Debt Collection Outsourcing in Australia”, Consumer Credit Legal Service Inc (Vic), 2002.

<sup>10</sup> [2002] QSC 171.

No. As we discussed in the introduction to this submission, the fundamental issue with fringe lending is the fact fringe credit products are so high a cost as to be unconscionable and exploitative. While greater information disclosure can assist in overcoming information asymmetry where asymmetry impedes consumer choice and thereby, efficient operation of markets, we consider that in the context of the fringe credit market, the concept of consumer choice tends to the meaningless.

The Discussion Paper largely assumes that the excessive cost of fringe credit can be forced down by increased competition, and that such competition will be facilitated by greater transactional transparency. In our view this assumption is fundamentally flawed. Fringe credit providers operate in a sector of the consumer credit market that is defined by the lack of choice available to market participants. Low income and vulnerable consumers have in recent years been increasingly shut out of the mainstream credit market. Where the mainstream market has denied them access to the credit products they need, the fringe credit market offers credit rates which cannot be considered reasonable. For example, in circumstances where they have an often desperate need for short-term cash, the marketplace has limited their choice to a choice between equally exploitative credit products.

In our experience, a large proportion of fringe credit borrowers are aware, or reasonably aware, of the high costs associated with fringe credit. Their choice is between participation or non-participation, but in most cases this is not a real choice.

The notion that enhanced information will provide fringe credit consumers with the ability to compare the competitiveness of different credit products is underpinned by a lack of understanding of the circumstances in which fringe credit is most often sought. Indeed, it has been found that in the context of payday loans, initial loans ‘are usually accessed in situations of considerable desperation in which the notion of consumer choice has little meaning’.<sup>11</sup>

In such circumstances, the concept of consumer choice tends to the meaningless. As such, the forces underpinning competition policy do not and cannot operate effectively at this level, and for these reasons, disclosure is not and cannot be the panacea for this type of lending.

In addition, we consider that the most vulnerable of fringe credit consumers – those in the most dire financial circumstances - are likely to have the lowest levels of financial literacy and therefore will be unable to identify and evaluate which credit products will address their needs.

In the first national survey on financial literacy levels in Australia, the *ANZ Survey of Adult Financial Literacy in Australia: Final Report* May 2003 (the **ANZ Report**), the correlation between low socio-economic status and low levels of financial literacy was highlighted. Financial literacy is defined to be ‘(t)he ability to make informed judgments and to make effective decisions regarding the use and management of money’.<sup>12</sup> The ANZ Report notes that:

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<sup>11</sup> *Payday Lending in Victoria – A research report*, above ref. 1, p. 78.

<sup>12</sup> This definition was adopted in the *ANZ Survey of Adult Financial Literacy in Australia: Final Report*, May 2003 from research in the UK conducted by the National Foundation for Educational Research.

*‘One of the clearest findings from the survey is the strong correlation between financial literacy and socio-economic status. The lowest levels of financial literacy were associated with those having lower education (Year 10 or less), lower incomes (gross annual household incomes under \$20,000), lower savings levels (under \$5000) and were at both extremes of age groupings (i.e. 18-24 year olds and those aged 70 years and over).’<sup>13</sup>*

The ANZ Report concludes that this finding is ‘of particular concern because financial knowledge was only tested against individual needs and circumstances rather than against the entire array of financial products and services, some of which they will neither use nor need’.<sup>14</sup>

Greater information disclosure will not assist low-income consumers if they are unable to understand or use that information.

The main market failure arises out of recognition by fringe credit providers of this captive market, and willingness to exploit that market. This is not so much a market operating inefficiently as it is a market operating contrary to community standards. The result is a serious inequity as the poorest members of our society are paying the highest market prices for credit, confirming the thesis of David Caplovitz’s classic text *The Poor Pay More*.<sup>15</sup> This serious inequity in the marketplace raises significant questions of public policy and consumer protection.

In order to provide necessary protection for vulnerable consumers, government must recognise these failures, and intervene to ensure that the opportunities for such exploitation are removed. The level of intervention required to ensure this outcome goes significantly beyond facilitating competition. The current inequity in the marketplace can only be addressed by a uniform model of robust consumer protection across all Australian jurisdictions.

We are also troubled by the suggestion that a market sector of this type is one in which competition is appropriate. Fringe credit is demonstrably exploitative, and would require fundamental changes to hold a justified place in a market that is safe. The Discussion Paper fails to examine the social utility of this market, although it is implicit in the proposed reforms that fringe lending is acceptable, provided it is not overly exploitative. As noted above, and particularly in the introduction, we believe a far more robust approach is required. A competitive fringe market acts as no more than a band aid solution to the problems associated with vulnerability – not a solution.

We would also argue that competition has categorically failed in this market. In the home loan market interest rates have remained relatively stable and low and yet, in the fringe lending market, interest rates continue to climb and remain unjustifiably high.

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<sup>13</sup> ANZ Survey of Adult Financial Literacy in Australia: Final Report, above, ref 5, p. 12.

<sup>14</sup> ANZ Survey of Adult Financial Literacy in Australia: Final Report, above, ref 5, p. 12.

<sup>15</sup> Caplovitz, David, *The Poor Pay More: Consumer Practices of Low Income Families*, 1967, Free Press: London.

In this regard, we note that one of the stated objectives of the Code is “to apply in a deregulated credit market and provide standards for the provision of credit that will not be overtaken by changes in the financial marketplace”.<sup>16</sup> The Discussion Paper identifies the fact that the growth of the fringe credit industry is due to mainstream credit providers moving away from servicing the lower end of the market, however, acceptable standards for the provision of credit have been allowed to lapse as a result of this change. As is discussed below in relation to 4.3.5, the appropriate mechanism for the provision of adequate standards at this end of the market is to impose an effective cap on the cost of credit. Fringe credit providers must be uniformly restricted from charging exorbitant costs for credit.

#### **4.1 Policy Options: Retain the Status Quo**

We agree with the conclusion that the costs of continuing the status quo outweigh the benefits to the community as a whole. We consider that appropriate government intervention is imperative.

#### **4.2 Policy Options: Self-regulation model**

We agree with the conclusion that this is not a viable option, for the reasons contained within the Discussion Paper. We consider that appropriate government intervention is imperative.

#### **4.3 Policy Options: Amend the Code**

We believe that appropriate government intervention will involve effective amendments to the Code. Importantly, there are significant benefits to be obtained for all parties, but particularly for consumers, in ensuring that there is a uniform legislative response to fringe credit.

##### **4.3.1 Prohibition on bills of sale over household goods - Discussion Points 17-20**

*17. How effective would a prohibition on bills of sale over household goods be in achieving the government’s objectives?*

We believe that such a prohibition would be particularly effective in protecting vulnerable consumers from intimidation, harassment, and potential loss of essential household goods, and support the conclusion that the benefits to the community as a whole would outweigh the costs associated with the prohibition.

The taking of bills of sale over household goods – commonly referred to as blackmail securities – is a particularly unjust practice that very effectively intimidates consumers. Fringe credit borrowers typically experience financial hardship, and have difficulty meeting every day expenses. A fringe credit provider who takes blackmail securities can effectively ensure that repayments are given particular priority by

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<sup>16</sup> Discussion Paper, page 17.

borrowers, even over essentials such as food, medication and so on. The threat to repossess household goods (or to have their home effectively “cleaned out”) is perceived by such consumers as very real, and is often utilised by fringe lenders to create an environment of fear.

(This is particularly so given that goods over which security is taken would often realise little if anything if sold, but may have significant emotional or intrinsic value to individual consumers, sometimes to the point of being irreplaceable.)

It is often the case that a fringe credit borrower, who has obtained fringe credit as a last resort, finally has no alternative but to bankrupt. As is noted in the Discussion Paper, the important protections conferred by the *Bankruptcy Act 1966* (Cth) in relation to those assets which can be seized are effectively undermined where blackmail securities are obtained.

Finally, we note the suggestion that one possible disadvantage to borrowers of such a prohibition would be increased transaction costs. Given the unreasonably high costs already associated with this form of fringe lending, we do not consider that this is a particularly relevant consideration, and certainly represents far less of a risk to consumers than is already being experienced.

See also Case Studies G and H (below).

20. *Do you think that the prohibition should extend to taking any form of security for loans under \$3,000? What would be the impact of such an option?*

It is essential that the prohibition extend to any form of security for lower value loans. Any type of security for a small loan is effectively blackmail security, whether the security is over a car worth more than the amount borrowed, or over household goods (or both). Threat of repossession of household goods has obvious consequences. Threat of repossession can raise more specific concerns, particularly given that for most borrowers their car is their only asset of worth, and is essential for travel. A particularly vulnerable group are single parents who need the car to drive children to school, or for regular or emergency medical needs. Such threats are disproportionately unjust and exploitative having regard to the small amounts usually outstanding.

We would argue that \$3,000 is too small an amount, and would strongly recommend that the threshold be set at an appropriately higher amount. Such an amount should be set having regard to the nature of this issue, and to the fact that the understanding of what constitutes a small loan is changing, with many lenders increasingly prepared to lend significant amounts to consumers reliant on social security as their sole source of income. Consumers reliant on such low (and fixed) incomes are particularly vulnerable, and require targeted protection.

(In addition, a higher amount will ensure continues relevance of the protection as the average small loan grows in value over time, although we would encourage an amendment that allows for indexation of the relevant threshold amount by Regulation.)

#### **4.3.2 Extra disclosure requirements - Discussion Points 21-26**

21. *Would you prefer the definition of a high cost loan to be tied to the BAB rate or to be a set rate ie. 30%?*

We would prefer the definition of a high cost loan to be a set rate, notwithstanding that this does not track the cost of money. A variable definition is likely to be sufficiently uncertain as to undermine compliance, which will materially compromise the protection of fringe credit borrowers.

22. *How effective would the extra disclosure proposals be in achieving the government's objectives?*

As discussed earlier, we do not consider that enhanced disclosure is the appropriate mechanism to ensure necessary consumer protection from the excesses of fringe lending.

Nevertheless, we support the extra disclosure proposals as an additional measure to complement other government intervention.

#### **4.3.3 Disclosure of APR - Discussion Points 27-32**

In our experience there is currently widespread inconsistency in the disclosure by fringe credit providers of APR's and/or fees. The case example on page 41 of the Discussion Paper illustrates the artificial nature of this distinction in recovering the costs of fringe credit products, and the manner in which that distinction can be manipulated in favour of the fringe credit provider. This lack of consistency makes costs comparisons between products – to the extent that it occurs or might occur – virtually impossible.

We support the proposal for government intervention to require disclosure of an APR.

We further refer to our comments below regarding 4.3.5 - Interest Rate Caps.

#### **4.3.4 Avoiding the application of the Code - Discussion Points 33-36**

We support all moves to remove any identified loopholes in the application of the Code, and support the proposals contained in the Discussion Paper for the reasons discussed.

It appears however as though the Discussion Paper assumes that the primary problem arising out of the involvement of finance brokers is that of additional or excessive fees. In fact one of the primary problems is that the involvement of a finance broker or other third party intermediary creates a barrier between borrower and lender that

can facilitate avoidance of the Code, particularly where a Business Purpose Declaration is utilised.

See generally our comments above in relation to Discussion Points 2 and 6.

In addition to identified loopholes or avoidance mechanisms, it is worth noting that compliance with the Code is undermined by an absence of enforcement. To our knowledge, there has been no prosecution of an offence under the Code in any jurisdiction since it came into effect. It is our view that this has led to lenders across the spectrum placing less priority on Code compliance, to the increasing detriment of all consumers.

#### **4.3.5 Interest rate cap**

There is no doubt that the high cost of fringe credit is unconscionable and exploitative.

To the extent that sections 70 and/or 72 of the Code offer any relief to fringe credit borrowers, they involve a mechanism that is inappropriate where the problem is systemic.

(We also note that section 72 is limited in its operation to specific types of fees. This creates a clear incentive to lenders to spread the high cost of their loans across a range of fees, each of which becomes in isolation far more difficult to challenge.)

As is noted above, CCLS (Vic) has commenced a number of proceedings in VCAT against the same fringe credit provider and in relation to the same issues pursuant to section 70 of the Code, all of which have settled. While this has benefited those consumers on whose behalf CCLS (Vic) acted, it has not and cannot be expected to bring about systemic change, and will not assist the vast majority of consumers who have obtained credit from that fringe credit provider. The costs of such intervention clearly outweigh the benefits, and do not provide consumers with the protections they require.

High cost credit is a systemic issue that requires a systemic response. The excessive cost of fringe credit cannot be justified on any policy grounds, and is supported only by the level of demand from and lack of choice available to fringe credit borrowers. It is a problem that cannot be ascribed to market inefficiency, and is one that requires targeted intervention.

The only effective means of preventing continued exploitation is through a cap on credit. An interest rate cap presents the lowest cost-to-government mechanism (other than retaining the status quo). It is also the best mechanism – and arguably the only mechanism – by which government can fulfil its consumer protection role and restore equilibrium to an otherwise distorted segment of the marketplace.

We strongly urge implementation of a uniform interest rate cap of 48% on consumer lending. Failure to do so will effectively deny vulnerable consumers the protection they require, and will allow their continued exploitation.

As is noted in the Discussion Paper, existing interest rate caps in the jurisdictions of the Australian Capital Territory and Victoria are currently compromised in that they do not incorporate fees and charges, enabling avoidance by unscrupulous fringe credit providers. We strongly urge adoption of a model which requires interest charges and all fees and charges to be included for the purpose of the calculating the maximum APR. In addition, given that fringe credit extends well beyond short term or pay-day type lending, we would not support a model limited to short term credit contracts as is currently the case in New South Wales.

## Case Studies

### Case Study A

A consumer on a pension was approached by a debt collector seeking payment of a credit card debt allegedly owing to a major bank. The collector wrote to the consumer, with the letter relevantly stating that:

First or second tier financial institutions that cater for those with affected credit ratings also offer loan packages and should be attempted.

We are in a position to accept an instalment arrangement only if [debtor] can show proof that loans have been attempted and declined.

### Case Study B

Mr. B had an intellectual disability and a gambling problem. He approached fringe lender for a loan of \$500 at 43% p.a. with an establishment fee of \$375. Mr. B has now had 4 loans from the fringe lender, with the subsequent loans being entered into to refinance existing loans when he was unable to maintain payments. Mr. B now owes over \$4000 with no means to repay the debt.

### Case Study C

Mr and Mrs C needed to borrow \$20,000 to pay some legal fees incurred by their son. They approached a finance broker to arrange an unsecured personal loan, however the broker actually arranged a business/investment loan for \$30,000 from a solicitor lender, secured by mortgage over their home (the additional \$10,000 covered fees to the broker and solicitor). The loan was for 1 year only with interest only repayments. The lender referred the C's to a solicitor for advice prior to signing the contract. The documentation included a Business Purpose Declaration, however the C's solicitor failed to advise of the consequences of signing the Declaration. Mr and Mrs C had no means to repay the loan at the end of the year.

Mr and Mrs C managed to pay the interest repayments until the end of the year at which time the solicitor lender offered a loan for \$40,000. The further \$10,000 being offered to cover further interest and fees to refinance the loan.

### Case Study D

Ms D is a single parent with her sole source of income being social security. She approached a fringe lender for a loan of \$2000 to consolidate some small personal loans. Her sole asset of any value was her car. Ms D approached a fringe lender who offered fast credit. Ms. D signed the loan not understanding that as the loan was a bill facility and she had signed a Bill of Exchange the Code did not apply as there is an exemption for bill facilities under the Code. Ms D's car has been repossessed as she could not afford the repayments of 15% per month (180% p.a.).

### **Case Study E**

Mr Moore, unable to afford his mobile telephone bill, contacted Fast Access Finance which had advertised finance with same day approvals in a local newspaper. He subsequently obtained a loan for \$300, with interest payable at 20% per month (240%pa), secured over his car. Once the loan was paid out he obtained another loan for \$500 on similar terms.

When Mr Moore challenged the high cost of the credit Fast Access Finance sought to rely on the pawnbroker exemption under the Code. The Consumer, Trader and Tenancy Tribunal of New South Wales found that although Fast Access Finance was a licensed pawnbroker, the transactions were not carried out in the ordinary course of a pawnbroker's business, and so the exemption did not apply. Evidence provided during the proceeding suggested that Fast Access Finance carried on all its business (at least during a specified period) on the basis that it was exempted from the Code.

*Moore v Fast Access Finance* [2002] NSWCTTT 591 (23 December 2002)

### **Case Study F**

Mrs F is a pensioner and needed a lounge suite for her home. Her daughter told her she had bought a fridge from an appliance store which would deal with pensioners. Mrs F rang the store, which agreed to give her a loan. Mrs F proceeded to pick out a lounge suite at a furniture store. She picked the colour and type of the lounge. She was assured that she would own the furniture after she had made the repayments listed on the loan contract. It turned out Mrs F has signed a rental contract and did not own the furniture at all (according to the contract). Worse still she was paying an effective interest rate on the loan of over 100%p.a.

### **Case Study G**

Ms G, a single unemployed mother receiving Centrelink benefits, entered into a credit contract for \$1,300, part of which was used to pay out an existing loan with the same lender. The establishment fee was \$350 and annual percentage rate 30%, bringing the total amount to be repaid to \$1,841.76. The loan contract secured a mortgage over most of her household goods and her car (despite the car being subject to a Bill of Sale under another credit contract).

Due to difficulties in making payments, and despite her requests not to direct debit her account due to a lack of funds, the credit provider continued debiting her account and she incurred bank dishonour and credit provider default fees (including phone call, letter and field call fees).

Following bankruptcy Ms G was harassed by the credit provider and she signed a direct debit authority agreeing to pay \$25 per week. The matter was subsequently resolved through the assistance of a financial counsellor and CCLS (Vic).

### **Case Study H**

Ms H, a single mother receiving Centrelink benefits, entered into a credit contract for \$600. The establishment fee was \$350, the loan application fee \$20 and the interest payable (at a rate of 30%pa) \$105.04. The total amount to be repaid was \$1065.24.

The contract secured a mortgage over most of her household possessions and her vehicle. Some of the household goods listed as security belonged to her parents, despite the credit provider's knowledge that they were third party items.

Following bankruptcy Ms H continued making weekly payments. Having sought assistance from CCLS (Vic) an application was filed in the Victorian Civil and Administrative Tribunal seeking appropriate remedies under section 70 of the Consumer Credit Code. At the time of the issuing of VCAT proceedings Ms H had paid \$330.80, but still owed \$1133.14, an amount in excess of that contracted for. The matter settled at mediation.

### **Case Study I**

Ms. I needed a loan to go on a holiday. Ms. I rang a finance broker who advertised in the Daily Telegraph. The finance broker then referred her to an accountant in the Sydney suburbs for a loan (after charging a fee for the referral). The accountant would not speak to Ms. I until she had paid him \$200 in cash. The accountant agreed to lend her \$6000 to be repaid over 18 months at \$350 per fortnight. This amounted to over \$7,000 in interest or an effective interest rate of around 70% p.a.

The accountant has now commenced proceedings in the Local Court claiming that Ms. I owes \$31,000 in interest in addition to the borrowed \$6,000 and the loan was only taken out 18 months ago!