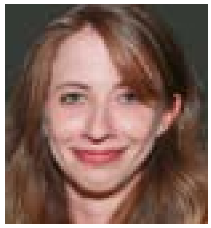
PAYDAY LENDING PRACTICES: WHY UNETHICAL LOANS ARE HARMING THE VULNERABLE

By Alexandra Kelly



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The recent *4 Corners* report 'Game of Loans' on the ABC, which showed payday loans being given to homeless heroin addicts, shocked many. It may have seemed hard to believe but it is something the Financial Rights Legal Centre (FRLC) sees regularly.

The FRLC (formerly the Consumer Credit Legal Centre) is a community legal centre in NSW that specialises in consumer credit and insurance. Its telephone advice line appears on utility bills, default notices under the *National Consumer Credit Protection Act 2009* ('*NCCP Act*') and, since 1 July 2013, it has appeared on a mandatory warning for consumers applying for Small Amount Credit Contracts (reg 28XXA *National Consumer Credit Protection Regulations 2010* ('*NCCP*')).

Snapshot

- A 'payday loan' or small amount credit contract is a credit contract for an unsecured loan of $2000 or less for a term of at least 16 days but not longer than one year. It excludes loans by authorised deposit taking institutions and continuing credit contracts.
- The case of *ASIC v The Cash Store* and ASIC *Report 426* suggest the regulatory tools to tackle poor lending practices in the industry are, to a large extent, already available. Effective enforcement, however, remains a major challenge, and society's most vulnerable continue to fall foul of unethical lending practices.

Small Amount Credit Contracts or 'payday loans'

A Small Amount Credit Contract (SACC) is a credit contract for an unsecured loan of $2000 or less for a term of at least 16 days but not longer than one year. It excludes loans by authorised deposit taking institutions and continuing credit contracts (*NCCP* s 5(1)). These loans are typically understood to be 'payday loans'.

The Caught Short report (2012 research involving RMIT,UQ, QUT, Good Shepherd and NAB) found that 80 per cent of the payday lending borrowers interviewed for the study were Centrelink recipients, 37 per cent of whom were on the Disability Support Pension. Loans were most commonly taken out for regular expenses such as food, bills and rent, or simply having 'no money'.

Over half the group of borrowers studied had taken out more than 10 payday loans in the previous two years, and three quarters of those had taken out more than 20.

The Report of the Parliamentary Joint Committee on Corporations and Financial Services ('PJC') tasked with looking into the issue in 2011 also noted that either the industry significantly underestimates the number of consumers accessing short-term loans or there is extensive and substantial repeat borrowing by consumers.

The profile of Financial Rights clients with payday loans accords closely with the findings of the Caught Short research. Recent examples include:

- Loans to the homeless;
- 18 SACC loans provided by one lender to one client in 18 months; and
- 18 payday loans provided over five years where the client received $13, 241 but had paid back $32,140.05.

Payday lending regulation in NSW

The *NCCP Act* has regulated consumer credit activities nationally since 1 July 2010. In NSW, however, a credit cap was initially maintained so the price of a loan in NSW could not exceed 48 per cent per annum, including any up-front fees and charges. In spite of this, payday lenders have still found ways to increase the amount to be repaid by consumers. When the new responsible lending provisions of the *NCCP* came into force in July 2010, some of the common avoidance models declined, but not all. Contracts having a stranger as co-borrower resident in a state with no cap on credit (eg Western Australia) were still common, as were deferred establishment fees (a strategy currently before the court in representative proceedings in the Federal Court: see *Cash Converters International Limited v Gray* [2014] FCAFC 111) used to avoid the cap.

The new regulator of credit, the Australian Securities Investment Commission (ASIC), released *Regulatory Guide 209,* which is a guide to industry as to the scalable requirements to ascertain a consumer's objectives and verify the capacity of a consumer to afford the repayments under a loan in accordance with the responsible lending provisions of the *NCCP*. All consumer credit lenders, including payday lenders, had to obtain a credit licence from ASIC and become members of an approved external dispute resolution scheme providing free and independent dispute resolution for consumers.

So-called responsible lending

Consumer advocates were keen to protect consumers from the usurious charges imposed for payday loans in states with no caps, so they argued for the 48 per cent cap on credit to be adopted nationally. Credit providers argued that the high cost of some loans, particularly small loans like payday loans, can be justified by a higher comparative cost of lending (overheads per dollar loaned) and the higher risk. Sympathetic to the plight of vulnerable borrowers, the draft Bill the Government originally put forward proposed a 10 per cent establishment fee and 2 per cent per month cap on a SACC and a maximum interest rate of 48 per cent for all other loans.

Industry argued however that the introduction of 'responsible lending' was the solution and that the proposed enhancements would destroy their business (see Submission from Cash Converters to the Joint Parliament Committee on Corporation and Financial Services for their inquiry into the Consumer Credit and Corporations Legislation (Enhancements) Bill 2011, October 2011).

Industry won and, in a loss to consumers, the cap was watered down to allow lenders to charge a 20 per cent establishment fee and 4 per cent per month. This is the equivalent of up to 250 per cent per annum, depending on the term of the loan.

However, other consumer protection mechanisms were introduced under the *Consumer Credit Legislation Amendment (Enhancements) Act 2012*, including:

i) a rebuttable presumption that loans would be unsuitable where a consumer was already in default under an existing SACC or the consumer had two or more SACCs in the previous 90 days;

ii) a limit on the amount a consumer can be charged when in default – ie not more than twice the amount of the original loan;

iii) limiting repayments to 20 per cent of income for consumers who receive 50 per cent or more of their income from Centrelink;

iv) a requirement to obtain and consider 90 days of the consumer's bank account statements; and

v) a warning required to be displayed (online and on premises) or conveyed verbally for telephone lending to advise consumers of the high cost of small amount credit and possible alternatives.

Despite the introduction of these protection mechanisms, it has the been the casework experience of the Financial Rights Legal Centre that there has been an industry-wide failure to lend responsibly.

ASIC v The Cash Store

The *Australian Securities and Investment Commission v The Cash Store Pty Ltd (in liquidation)* [2014] FCA 926 ('*ASIC v The Cash Store*') decision is an example of a payday lender systemically failing to comply with the responsible lending laws. The case covered payday loans entered into between 1 July 2010 and 24 September 2012, prior to the commencement of the SACC cap but after the commencement of responsible lending.

The Cash Store ('TCS') arranged 325,756 individual credit contracts to 52,000 clients for amounts of up to $2200 for periods of between one and 36 days. Many of the loans were overlapping with clients refinancing interest on interest. TCS sold 182,838 'payment protection plans' – a consumer credit insurance (CCI) product collecting $2,278,404 of premiums, including sales to Centrelink recipients who would never be eligible to claim. Justice Davies found systemic and gross failures with a wholesale failure in process to make reasonable inquiries of customer requirements and objectives, or to inquire about their regular expenditures and other liabilities. Where inquiries were made, there was no evidence of subsequent verifications. Credit guides and disclosure documents were not provided in some instances. Her Honour found that the sale of useless CCI to Centrelink recipients was unconscionable.

ASIC obtained a record penalty of $18,975,000 against The Cash Store Pty Ltd (in liquidation) ('TCS') and loan funder Assistive Finance Australia Pty Ltd ('AFA').

ASIC has since released *Report 426 – Payday lenders and the new small amount lending provisions*, ('ASIC *Report 426*') a review of the industry's compliance with the 'enhancements' contained in the *Consumer Credit Legislation Amendment (Enhancement) Act 2012*. Among other things, the report found that of the 288 files reviewed, 62 per cent triggered the presumption of unsuitability, yet only one of the 13 lenders reviewed indicated they made any further inquiries on file; and many online lenders reverted to pro forma responses such as 'temporary cash shortfall' rather than allowing a consumer to state their objective.

The *Cash Store* case and ASIC *Report 426* suggest the regulatory tools to tackle poor lending practices in the industry are, to a large extent, already available. Effective enforcement, however, remains a major challenge and is likely to be very resource intensive. Further, the breaches identified in *Cash Store* were so fundamental and procedural that the decision fails to resolve many questions raised by the legislation, such as: what is substantial hardship, and what would be sufficient to rebut the presumptions of unsuitable lending? The case was also undefended.

After the introduction of the SACC cap the industry is booming

Since the 'enhancements', the payday lending industry has seen larger operators acquire smaller operators and report record-breaking performances (see Cash Converters Annual Report showing a record-breaking December 2014 with personal loans and cash advances up by $23 million (25.5 per cent)).

Online lending has surged. Online and television advertisements saturate daytime television, offering immediate approvals and same-day deposits. Television advertisements are directed at consumers as being 'hip' and 'smart' options to pay utility debts and buy presents. Worryingly, research undertaken by Lonergan Research for the Consumer Action Law Centre in March 2015 found Australians aged 18 to 24 are less likely to believe the interest fees and charges are unreasonable (46 per cent of those surveyed compared with 79 per cent of those surveyed aged 35 to 49 or 83 per cent of those aged 50 and over). Advertisements and credit contracts for SACCs do not have to show the annual percentage rate or cost of the credit.

While financial literacy efforts by government and others struggle to instil the concept of good debt (capacity building) and bad debt (income sapping), this industry promotes instant gratification and the temporary fix. Payday loans were formerly one of very few options for low income, marginalised borrowers between a rock and a hard place. Now they are being promoted as a mainstream option – and they don't even have to advertise their price in comparable terms. In a world where disclosure and truth in lending have prevailed for decades (and unit pricing is required for groceries) this seems inconceivable.

The relevant provisions are due to be reviewed later in 2015. Once again, the government will need to weigh up the costs and benefits of providing access to credit for some segments of the community against the damage wreaked on the personal budgets of our most vulnerable citizens over the longer term. **LSJ**