Submission by the
Financial Rights Legal Centre

SACC Review Panel

Review of the small amount credit contract laws: Interim Report, December 2015

January 2016

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About the Financial Rights Legal Centre

The Financial Rights Legal Centre is a community legal centre that specialises in helping consumer's understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable consumers. We provide free and independent financial counselling, legal advice and representation to individuals about a broad range of financial issues. Financial Rights operates the Credit & Debt Hotline, which helps NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies. Financial Rights took over 26,000 calls for advice or assistance during the 2014/2015 financial year.

Financial Rights also conducts research and collects data from our extensive contact with consumers and the legal consumer protection framework to lobby for changes to law and industry practice for the benefit of consumers. We also provide extensive web-based resources, other education resources, workshops, presentations and media comment.

This submission is an example of how CLCs utilise the expertise gained from their client work and help give voice to their clients' experiences to contribute to improving laws and legal processes and prevent some problems from arising altogether.

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Introduction

Thank you for the opportunity to comment on Interim Report of the review of the small amount credit contract laws. We make the following recommendations:

RECOMMENDATIONS:

- Additional responsible lending obligations are required in relation to SACCS. The presumptions have not succeeded in addressing the harm as intended and are poorly complied with. ASIC enforcement should be a priority.
- <u>Options 1, 2 and 3</u> should all be introduced to replace the current rebuttable presumptions which have failed to have a significant effect.
  - Option 2 should be less than 2 loans per 90 days.
  - Option 3 should apply a lower percentage of 5% of net income. The 5% should be a cap on the total of repayments towards any SACC, Consumer lease and Centrelink advance.
- Options 4 and 5 should both be implemented. The maximum permissible amount recoverable should be retained as the ultimate protection.
- Options 7 and 8 should both be implemented.
- Consumer leases should be subject to the same level of protection as all other regulated products.
- A cap of 48% per annum on the maximum amount a lessor can charge should be introduced for all leases, consistent with other regulated loans.
- A 48% cap should apply to all types of consumer leases, not only low-value household and electronic goods.
- There should be a limit imposed on the maximum length of leases to balance the benefits of lower repayments against the additional cost of credit incurred by longer term contracts. This could be set by reference to a number of years, or by limiting the total amount payable to a multiple of the cash price.
- The cash price of goods should be determined as follows:
  - **New goods** should be determined by "market value"
  - **Older unused goods** should be determined by "market value" depreciated according to standard ATO depreciation calculations
  - **Second-hand or re-rented goods** should be determined by "market value" depreciated by standard ATO depreciation calculations, and then depreciated by an additional 10%.

- The cash price and accurate description of the goods must be disclosed on the consumer lease contract. A comparable interest rate should also be disclosed.
- Include the cost of add on features under the cap whether paid for by cash or financed under the lease.
- Apply the cap to all leases.
- If delivery charges are not included under the cap, they should be separately disclosed and capped and should not be permitted to be financed (incur interest payments).
- There should be a 5% cap on the percentage of net income that can be committed to repayments, which includes the total amount of repayments made towards any SACC, Consumer lease or Centrelink advance.
- Option 12 should be implemented. Termination fee should be the lesser of:
    - The lessor's reasonable costs incurred by reason of the termination or
    - Two months rental under the contract.

The Financial Rights Legal Centre will address the report's Observations, Options and requests for further information in order below.

Chapter 1 – Overview and Background

Observation 1: One of the key outcomes of regulation in the financial sector should be the facilitation of consumers onto a path of financial inclusion rather than exclusion

Financial Rights agrees with Observation 1.

The evaluation of the Good Shepherd Microfinance NILS program by the Centre for Social Impact, *Life changing loans at no interest*, notes in its literature review that:

> *"Credit exclusion can exacerbate financial hardship, decrease social and economic participation and adversely affect health and mental wellbeing because it makes asset building, cash flow management and buffering against financial shocks or unexpected expenses more difficult. This might drive individuals to use fringe credit providers."*[1]

As the case studies provided in our initial submission to this Review demonstrate, SACCs operate serve to further entrench the effects of financial exclusion rather than address them.

[1] Centre for Social Impact, *Life changing loans at no interest*, March 2014, p29 available at http://goodshepherdmicrofinance.org.au/sites/default/files/GSM_NILS_Report.pdf

In Case Study 1 of our original submission to this Review[2] our client turned to SACCs to address his financial problems only to find that his problems intensified. To repay these loans he borrowed from girlfriend/friends, used cash advances from Centrelink, and accessed other payday loans. His mental health issues – schizophrenia, anxiety and depression – worsened in part because of the financial situation and he was hospitalised due to a nervous breakdown. He now wants to be banned from getting any more of these loans. In Case Study 2 our client turned to a pay day loan, and started a vicious circle of borrowing that went on for 18 consecutive loans. Case Study 6 represents a similar scenario, where our client turned to a continuous chain of loans rather than addressing a cash flow problem, simply creating further, self perpetuating financial stress, as additional income was drained in fees and charges from an already precarious situation.

Further Information Requested: Information on trends in the SACC and leasing industries including consumer characteristics.

Unfortunately we do not have any additional information on trends or borrower characteristics beyond what we included in our initial submission in October 2015.

Chapter 2 – Responsible Lending Obligations for SACCs

Observation 2: The responsible lending obligations do not appear sufficient to prevent financial harm to consumers who use SACCs. Additional consumer protection specific to SACCs seems to be required. ASIC enforcement of the responsible lending practices of SACC providers should be a priority.

Financial Rights strongly agrees with Observation 2. We refer to the evidence in our original submission to this Review.

Recommendation

Additional responsible lending obligations are required in relation to SACCS. The presumptions have not succeeded in addressing the harm as intended and are poorly complied with. ASIC enforcement should be a priority.

Chapter 3 –SACC Provisions

Observation 3: High levels of repeat borrowing appear to be causing consumers financial harm. The structure of the SACC cap and industry costs appears to promote repeat borrowing and the rebuttable presumptions do not appear to have limited repeat borrowing.

Financial Rights strongly agrees with Observation 3.

2 Financial Rights Legal Centre submission to the Review of small amount credit contract laws, September 2015, Appendix 1

OPTION 1: *Reduce the establishment fee for subsequent loans for a returning customer from 20 per cent to 10 per cent.*

Financial Rights strongly supports Option 1 as it will:

- Directly address the high impact of the cost of these loans on disadvantaged individuals' financial position (the poor will still pay more but somewhat less than is currently permitted);

- Indirectly address repeat borrowing by removing the structural incentive in the cap for lenders to encourage repeat borrowing leading to more suitable product design; and

- Promote financial inclusion by both freeing up income to pay other essential expenses and reducing the likelihood consumers becoming trapped in a cycle of repeat borrowing where they get an initial loan to meet a one off expense but then need to continually get additional loans because they cannot pay off the initial loans.

Currently lenders are able to charge a 20% establishment fee every time they initiate a loan, even though the bulk of the cost of loan initiation is incurred the first time they lend to a consumer only. It is therefore in the lender's interest to structure the loan over a fairly short term, with repayments high enough to ensure the consumer needs to return for another loan at the end of the term, allowing the lender to charge another 20% establishment fee[3]. Lowering the amount that can be charged for subsequent loans both recognises the lower costs involved in initiating loans to established customers and removes some of the incentive to lend frequently as opposed to according to capacity and need. We note that many of the costs of loan initiation are not fixed, but variable depending on the amount expended in trying to attract market share (search engine optimisation, referrals fees, advertising etc.) and can be adjusted according to available revenue.

This adjustment to the costs recoverable should serve to promote better product design – lower repayments over a longer period at reduced overall cost to the consumer. This should in turn address affordability and reduce the likelihood of the vicious cycle of borrowing to meet prior loan commitments or the income deficit created by them.

OPTION 2*: Replace the rebuttable presumption that a SACC is unsuitable if a consumer has had two or more SACCs in 90 days, with a bright line test banning the provision of SACCs to consumers who have had two or more SACCs in the past 90 days.*

Financial Rights supports Option 2 but we believe the bright line ban on the amount of loans a consumer can have within 90 days should be lower.

Many of our current clients with pay day loans are already in trouble with no more than two pay day loans per quarter. While limiting repayments to a set percentage of income will address many issues with loan affordability and repeat borrowing, some borrowers will remain perpetually indebted to their detriment (seeking another loan as soon as one as been paid out)

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[3] The Credit Corp Submission to SACC Review (October 2015) provides a good analysis of the impact of loan term on affordability at pages 14-16.

without a hard limit on the number of loans permitted. Small amount loans are promoted as a solution to one off emergencies, while the reality is repeat borrowing and a long term drain on the income of already financially stressed consumers. Setting a hard limit on the number of loans would address this issue directly and ensure the reality is closer to the rhetoric.

Alternatively a circuit breaker of a minimum time between loans, or after a set number of loans, such as has recently been adopted in the United States, could be applied to give people the opportunity to break the cycle of dependence.[4]

OPTION 3: *Extend the protected earnings amount for Centrelink recipients, where total SACC repayments cannot exceed 20 per cent of gross income, to all consumers and lower the protected earnings amount to no more than 10 per cent of net income.*

Financial Rights supports Option 3 however we support further reducing the applicable percentage of earnings to 5%.

ASIC reports a comparably high level of compliance with the protected earnings provisions currently imposed for Centrelink recipients[5], suggesting this regulation could be complied with reasonable ease. This protection also goes to the heart of the harm of pay day lending by ensuring that loans are affordable, rather than leading to debt cycles and spirals.

We submit that 10% is nonetheless too high for a short term loan for less than $2,000. It is certainly too high for the vast majority of Centrelink recipients, but arguably other lower income earners also. As a percentage of income, there is no doubt that housing, energy and water, food and essential travel absorb the lion's share of a low income, and rightfully so. To ensure that SACCs address short term need without creating long term problems, such as inability to meet housing payments, disconnections, and other exclusionary effects, it is important to keep repayments as affordable as possible. The submission to the review by Credit Corp Group Limited reported that repayments on Credit Corp contracts represented about 4.8% of after tax income on average, indicating that setting the limit at 5% is quite feasible in practice.[6]

Additionally the capped percentage should apply to net earnings not gross and it should be inclusive of any other SACC repayments, consumer leases and Centrelink advance repayments.

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[4] http://www.consumerfinance.gov/newsroom/cfpb-considers-proposal-to-end-payday-debt-traps/

[5] Submission by the Australian Securities and Investments Commission to the review of the small amount credit contract laws, October 201, p17 & 35.

[6] See Credit Corp Submission to SACC Review (October 2015): "Credit Corp's average SACC is for $835 over six months with 13 fortnightly repayments of $85. Credit Corp's fortnightly repayments (which on average absorb less than 5% of a borrower's after tax income) are manageable for consumers on lower incomes and effectively minimise the need for repeat borrowing and the risk of a debt spiral, being one of the main public interest considerations driving the 2013 reforms. To date, 35,000 consumers have successfully avoided higher cost and unsustainable 'payday loans' through Credit Corp's SACC product." (pg 7 of submission)

Further Information Requested: Is policy option 2 or policy option 3 more effective at improving consumer outcomes? Please consider the cost and benefit of both options including the effect on competition, fairness, innovation, efficiency, access to finance, regulatory compliance costs and consumer protection.

Financial Rights strongly supports implementing all three Options simultaneously. However, if this is not possible we think combining Options 1 and 3 will have the most significant impact in reducing borrower harm.

Further Information Requested: In relation to policy option 3, what percentage cap on repayments, relative to income amount, would be most appropriate to promote financial inclusion?

As discussed above, we believe a 5% cap on repayments relative to income amount is more appropriate than 10%.

Further Information Requested: Does the cap on repayments need to be broader than just SACC repayments? For example, should lease repayments and other fixed obligations also be included?

Case study

A sole parent with dependent children, two of whom have special needs, was recently referred to Financial Rights for assistance in relation to a Medium Amount Credit Contract. The material prepared by the referring financial counsellor revealed that the client has many debts including credit card debts from some years ago being pursued by debt collectors, accumulated debts for utilities, two recent SACCs, 3 concurrent consumer leases with different lessors and a Centrelink Advance.

Yes, absolutely. The cap on repayments should definitely apply to any consumer lease repayments as well as Centrelink advances. These are the three types of credit most commonly held by pay day lending clients to meet the same need to address cash flow deficits, and to acquire household appliances (particularly leases).

As responsible lending still applies (and we strongly argue it should), it is preferable to keep this obligation simple to aid compliance and not include other types of credit - a loan will still be in breach of the responsible lending provisions if the person has insufficient income after fixed expenses and other loans to meet the repayments.

Housing and car loans also meet the essential needs of housing and transport – if they were deducted before the percentage was applied, then so should rent and travel expenses etc. Applying a fixed percentage of net income for the three identified types of credit above, overlaid with general responsible lending obligations, is less likely to lead to unforeseen consequences. At the same time it addresses the core failure in this market segment to keep repayments at affordable levels using the responsible lending provisions alone.

Further Information Requested: In relation to policy option 3, would a higher percentage of income, applied to the consumer's net income, subtracting lease repayments and other SACC or lease payments, be more appropriate? Are providers able to ascertain these figures?

We do not believe setting the cap at a higher percentage of income is necessary in order to apply the cap to net income instead of gross. Nor is a higher percentage necessary in order to include lease repayments.

Recommendation

Options 1, 2 and 3 should all be introduced to replace the current rebuttable presumptions which have failed to have a significant effect.

Option 2 should be less than 2 loans per 90 days.

Option 3 should apply a lower percentage of 5% of net income. The 5% should be a cap on the total of repayments towards any SACC, Consumer lease and Centrelink advance.

Default Fees

Observation 4: The limit on the amount that a SACC provider can recover in the event of default is an important safeguard for consumers. However, in some circumstances, the fees charged on default appear to be charged in a manner that significantly disadvantages vulnerable consumers.

Financial Rights agrees with Observation 4.

OPTION 4: *Introduce a default window, where no default fees can be charged until the consumer has missed a payment by one payment cycle.*

OPTION 5: *Maintain the current maximum amount recoverable for default of a SACC but introduce a supplementary cap to limit how quickly fees can be charged (for example, $10 per week).*

Financial Rights submits both Options 4 and 5 should be implemented.

Option 4 - The majority of SACC borrowers are in financial hardship by definition when turning to these loans. This usually means juggling multiple commitments with insufficient income. Allowing a full repayment cycle's grace before default fees are added will both reduce the likelihood of the loan becoming a debt trap and give borrowers an incentive to pay as soon as they can, even if not on the due date.

Option 5 - The limit on the rate at which the fees can be charged up to the maximum permissible amount after the grace period is an appropriate balance between providing an incentive to pay and covering lender's enforcement costs. Our experience as consumer advocates has shown the inevitable debt trap caused by default fees, particularly for the demographic groups using this type of product – the borrower can't afford to pay on time and then can never catch up because of rate at which additional fees are charged. We submit that $10 per month would be an appropriate limit on the rate at which default charges can be added.

Option 5 also addresses the issue that the current fee structure allows for higher default fees on shorter term loans because less of the maximum amount able to be recovered is used up in monthly fees. This change would also serve to nudge lenders towards more consumer friendly product design (longer loans with lower repayments) by eliminating another incentive to provider shorter term loans.

OPTION 6: *Cap default fees as a percentage of the amount outstanding on the SACC.*

Option 6 would be more complicated to monitor and would still allow punitive default fees where consumers default early on larger loans.

Further Information Requested:

- What costs do lenders incur when a consumer defaults?
- In relation to option 4, what are the typical payment cycles and what is the most appropriate default fee window?
- What is the appropriate level of the default caps under option 5 and 6? If you are a SACC provider, please also provide evidence of the actual costs that you incur as a result of a consumer's default.

We have no comments on these requests for further information.

Recommendation

Options 4 and 5 should both be implemented. The maximum permissible amount recoverable should be retained as the ultimate protection.

Anomalies arising from the SACCs Cap

Observation 5: Some SACC providers do not appear to be giving consumers any benefit or discount when they make early repayments or pay back the loan in full before the due date. These practices may result from the SACC cap being based on a fee, rather than an interest rate.

OPTION 7: *Provide SACC consumers with a benefit for early repayment by specifying the reduction in payment that would arise from early repayment of a SACC (whether in full or in part).*

Financial Rights considers that the flat fee structure permitted in relation to SACCs is unfair, results in anomalies, and defeats truth in lending principles by making it difficult for consumers to compare the cost of SACCs with other forms of credit. Ideally we would want the interest payable to reduce in line with the loan balance.

However, in the absence of an interest rate payable on the daily outstanding balance, Financial Rights supports the implementation of Option 7.

OPTION 8: *Require SACCs to have equal repayments over the life of the loan, while still allowing consumers the ability to pay off a SACC early.*

Financial Rights supports the implementation of Option 8 in order to prevent lender manipulation of repayment structures to maximise fees and charges. We believe both Options 7 and 8 could be implemented simultaneously as they address different issues.

Further Information Requested:

- Should lenders under a SACC be required to provide consumers with a benefit for early repayments of the balance and, if so, how should any such requirement operate? Should the same requirement apply to both the fee-splitting model and where the loan is repaid in full early?
- Are there circumstances in which SACC providers require consumers to make repayments for different amounts? If so, in what circumstances is this done and what is the difference in the size of repayments?
- To what extent do SACC providers charge fees in respect of outstanding months when a consumer repays a SACC early?

We have no comments on these requests for further information apart from the information about the fee splitting model provided in our original submission.

Recommendation

Options 7 and 8 should both be implemented.

Chapter 4 – Consumer Leases

Observation 6: The high cost of consumer leases appears to be causing consumers financial harm. While there are technical differences between credit contracts and consumer leases, these differences do not appear to justify consumer leases being excluded from the consumer protection regulations that apply to other forms of finance under the Credit Act.

Financial Rights strongly agrees with Observation 6, there is no justification at all for consumer leases to be excluded from the consumer protection regulations that apply to other forms of finance under the Credit Act.

OPTION 9: *Introduce a cap on the maximum amount a lessor can charge. The cap would apply to a defined class of leases covering low-value goods.*

Financial Rights strongly agrees with the introduction of a cap on the maximum amount a lessor can charge. We submit the cap should be the same 48% interest cap that applies to all non-SACC loans as leases go over longer periods than SACCS.

We strongly argue that this cap should apply to all leases, not only leases for low-value household or electronic goods. If this cap does not apply to all consumer leases we submit regulatory arbitrage will be inevitable. Unaffordable car leases are a major problem for the same cohort of borrowers and such higher-value leases would not be caught by a cap that was limited to low-value items.

We do not support a higher cap for low value consumer leases equivalent to the SACC fee regime. The SACC fee regime was introduced to accommodate the very short term nature of pay day lending (less than 12 months and often less than 3 months). The industry argued that a normal interest charge based on the daily outstanding balance would produce insufficient revenue over such short loan terms to cover the cost of initiating and administering the loans. This was a compromise between the competing objectives of ensuring access to small amounts of credit generally unavailable in the mainstream and preventing the poor from paying more. There is no such argument applicable in the case of consumer leases, which generally run for periods of 1-4 years. As such, there is no reason to adopt a cap any different to that which is adopted for credit products generally.

Further Information Requested: All other products regulated by the Credit Act are subject to a cap on costs. Is there any reason why users of consumer leases for low-value household or electronic goods should not have the benefit of this protection?

No.

Recommendation

Consumer leases should be subject to the same level of protection as all other regulated products.

A cap of 48% per annum on the maximum amount a lessor can charge should be introduced for all leases, consistent with other regulated loans.

Considerations for implementing a cap on Consumer Leases

Further Information Requested:

- If a cap on the cost of leases were to be introduced, is there a reason for lessors not to be subject to the 48 per cent cap that applies to credit contracts in general?

- Should there be a limit on the maximum term of a consumer lease?
- If a cap on the cost of leases were introduced, which types of leases should the cap apply to?

There is no reason for lessors not to be subject to the 48% cap that applies to credit contracts in general. The proposed cap should apply to all types of consumer leases, including car leases. Making changes to part of the lease market without addressing the remainder will create new opportunities for lease contracts to be structured to avoid the operation of this cap.

All cases where a consumer pays more for the goods than their retail value should be treated as a regulated credit contract an subject to a 48% cap. This would be the least complicated and most effective way to address the problems in the market.

Maximum lease length

The ideal length for a consumer lease would vary depending on the consumer's circumstances. For a consumer with adequate capacity to pay, a shorter term lease, which repays the cash price of the goods within a shorter timeframe, and minimises the effective cost of credit is preferable[7]. However, for clients on a lower income, reduced fortnightly payments may be a higher priority than the cheapest overall cost. The goal is to balance the competing objectives of ensuring affordable repayments for the consumer at the same time as containing the extent to which the overall cost to the consumer is inflated to exploitative proportions. One way of achieving this would be to cap not only the annual percentage rate, but also the multiple of the cash price payable under the contract over the term (for example, total cost should not exceed 1.6 times the cash value of the goods[8]).

In any event we do not think consumers should be paying to lease household goods for longer than the period over which the goods would be totally depreciated at ATO rates – this would suggest a period of 3 years or less.

Case study

In case study 5 of our original submission our 67 year old client with Parkinson's disease, Diabetes Type II (on insulin), short term memory problems and other physical issues has a disability and needs assistance to go anywhere. Her financial counsellor advises that she sometimes does not buy medicine in order to pay loans and bills.

In addition to the SACC, this client had two leases over 36 months, one costing $65 per fortnight and the other $25. The cash price of the first leased item was $639 and the second $459; the total amount payable under the leases in each case was $3,120 and $1,950 respectively, amounting to interest rates of roughly 242% and 108%. The total amount paid under these leases was over 4 times the cash price of the goods.

[7] See ASIC Report 447: Cost of consumer leases for household goods, September 2015, p19, para 43; Review of small amount contracts, Interim report, December 2015, p30.

[8] This is just an example based on the Table at page 30 of the Interim Report. It has not been subjected to any modelling to determine the impact on contracts for various amounts at 48%.

Further Information Requested: How should the cash price for determining a cap on leases be determined?

The definition in s204 NCC is a good starting point for determining the cash price of new leased goods. We rely primarily on s204(b) of this definition re "market value". However, consumer advocates have had a great deal of difficulty establishing 'market value' in our casework, so some further statutory direction would be helpful.

Regardless of further statutory direction, we submit that the "market value" must be disclosed in the consumer lease contract, including some explanation for how this value has been ascertained by the lessor.

For older models, but not second hand items

Some leased items are little older, but have not been rented out before. This is common for electronic items that get superseded quickly e.g.: renting a Play Station 3 when the current model is a Play Station 4. Assessing the market value can be difficult when these goods are no longer available for purchase at a retail outlet.

Consumer advocacy groups have agreed that a workable "formula" to determine the cash price of these items is:

(a) Start with the "market value" as defined in s204 NCC; then

(b) Depreciated the goods in accordance with the ATO recommended guidelines.

Depreciation is a recognised and readily available measure of the declining value of goods and would not be a significant additional administrative burden.

Second hand / re-rent items

Determining the cash price of second-hand goods has been particularly challenging for consumer advocates and caseworkers. Nevertheless, a workable proposal is to go through (a) and (b) above, then take off a further 10% to account for the fact the goods have been used by someone else. We believe this additional depreciated amount appropriately acknowledges the declined value of items that have been previously used without creating much additional administrative burden on lessors.

Disclosure

In order to ensure that the above calculations are applied consistently by lessors and to assist consumers to make reliable price comparisons between lease companies, the following must be required:

- the cash price of the goods must be disclosed on the contract; and
- the goods need to be accurately and specifically described (e.g.: make and model).

Recommendation

A 48% cap should apply to all types of consumer leases, not only low-value household and electronic goods.

There should be a limit imposed on the maximum length of leases to balance the benefits of lower repayments against the additional cost of credit incurred by longer term contracts. This could be set by reference to a number of years, or by limiting the total amount payable to a multiple of the cash price.

The cash price of goods should be determined as follows:

- **New goods** should be determined by "market value"
- **Older unused goods** should be determined by "market value" depreciated according to standard ATO depreciation calculations
- **Second-hand or re-rented goods** should be determined by "market value" depreciated by standard ATO depreciation calculations, and then depreciated by an additional 10%.

The cash price and accurate description of the goods must be disclosed on the consumer lease contract. A comparable interest rate should also be disclosed.

Whether a cap should include or exclude add on products

Observation 7: During consultation, stakeholders noted that a large proportion of the cost of consumer leases can be attributed to add on products. There is little transparency regarding the nature or cost of these services and the value that they provide to consumers. It may not be clear to consumers that these features are available when they enter into a lease or that they extend beyond the statutory guarantee under the Australian Consumer Law.

In relation to Observation 7, Financial Rights queries the value of the add-on services described. Our clients never appear to have taken advantage of any such services.

OPTION 10: *Include the cost of add on features and products under the cap.*

We support the implementation of Option 10. The cap should apply to total costs whether financed or paid by cash, and include any final payment required to obtain ownership of the goods to prevent the loading up of any costs not covered by the cap. In an overwhelming majority of cases the consumer expects to own the goods at the end of the lease and any failure to include this cost is simply misleading. Whether or not the consumer gets to own the goods and the cost and mechanism for transferring ownership needs to be clearly disclosed.

Option 10 would also have the added advantage of allowing the cost of leases to be quoted as a comparable interest rate, thereby promoting competition with other finance options and reducing the likelihood of the type of exploitative differential pricing exposed by the 2015 ASIC Report (447) into the cost of consumer leases.

Further Information Requested: If a cap on the cost of leases was introduced, how should add on products be treated?

All add-on products and services should be included in the cap (with the possible exception of delivery fees – see below). As consumer advocates, we almost never see consumers take advantage of these add-on products, nor have we noticed any contractual rights to such services in contracts we have perused for casework purposes (although we have not surveyed the market in any systematic sense). We submit that the value offered by these products is very limited, especially considering that the lessor is under a statutory obligation under the Australian Consumer Law to provide goods that are durable, and providing warranties at an extra cost is likely in breach of the law.

Further Information Requested: Are there ways of measuring the value of add on products to the consumer (for example, data on the extent to which consumers utilise those products or make claims under them)?

As noted above, our clients do not report taking advantage of these services.

Further Information Requested: What are the consequences of including add on services within the cap? Does this pose a particular risk for certain add on features or parts of the market (such as remote areas)?

Ideally delivery fees would be separately disclosed and included in the calculation of whether a particular contract exceeds the cap on costs. However, if the Panel is of the view that this would either:

- Severely limit access to leased goods for remote communities, or

- Necessitate a higher cap for leases than for other credit products (48%);

Then we would argue that the delivery fee should not be included in the overall cap on cost, but should instead be separately capped. If this is not done there is a significant risk that lessors may use the delivery fee exception to recover revenue they have lost as a result of the imposition of the cost. This is what we saw for a decade or more under the 48% cap in NSW-costs loaded into broker fees, cheque cashing fees, access card fees – and the reason for the tight definitions and all inclusive nature of the cost caps under the national credit law.

If the delivery charge is not included in the cap then it must be restricted to:

- The reasonable cost incurred by the lessor or
- A prescribed dollar amount;

whichever is the <u>lesser</u> amount.

It is also arguable that the prescribed amount should be further limited by reference to the value of the goods. For example, if the maximum delivery fee that could be charged was $200, this would represent 50% of the cash price of a leased item valued at $400 – a very high price to pay. Lessors can reduce costs by making bulk deliveries. Lessees may also have other options to collect the goods (or have them collected by others) that are not considered because the delivery cost is currently opaque and absorbed by excessively high rental payments.

The fee must also be clearly disclosed in the contract and cannot be subject to interest charges, regardless of whether it is paid upfront or in instalments along with rental payments.

Observation 8: If a cap were to be introduced on a restricted category of consumer lease, it should be designed in a way that limits the risk of avoidance. Although extending a cap to all leases and broadening the scope of the Credit Act to include indefinite term leases are matters outside the terms of reference of the review, government may wish to consider the implications for those leases outside the scope of this review.

In relation to Observation 8 we have already expressed our concerns above about the inevitable result of treating low-value lease differently from the rest of consumer leases. The Government should extend any applicable cap to all leases.

Should the cap be applied to all consumer leases, including add-on products and services under the cap would also address the rampant cost increases attributed to the addition of add-on products which is currently a major problem in the low-value car finance market for low-income and disadvantaged consumers.

Recommendation

Include the cost of add on features under the cap whether paid for by cash or financed under the lease.

Apply the cap to all leases.

If delivery charges are not included under the cap, they should be separately disclosed and capped and should not be permitted to be financed (incur interest payments).

Lease Affordability

Further Information Requested: Are stakeholders able to provide information on whether there are broad or systemic problems with the way in which lessors comply with the responsible lending requirements in relation to low-income consumers and Centrelink recipients?

We refer to the Cases Studies in Appendix 1 of our original submission. In our experience the credit assessment conducted in relation to consumer leases is not generally compliant with the credit law, and would not meet the additional requirements for SACCs either in so far as bank statements are not necessarily obtained and reviewed and clients are placed in contracts when they are already overcommitted and in breach of other obligations.

OPTION 11: *Cap the amount of net income that can be used to service all lease repayments.*

Financial Rights strongly supports the implementation of Option 11 although along with Option 3 we believe the capped income amount should be reduced to 5%. This reduced income amount is manageable for lower income consumers and will help to minimise the need for consumers to repeatedly use high-cost lease products as well as SACCs.

The capped income amount should include all lease payments along with SACC repayments and Centrelink advances.

Further Information Requested: Should a protected earnings amount be introduced for leases, similar to option 3 canvassed in relation to SACCs?

Yes.

Further Information Requested: If a cap restricting the amount of income that can be used to make lease repayments were introduced, what level would be affordable for consumers and lead to financial inclusion?

We support a 5% cap restricting the amount of income that can be used to make lease repayments (SACC repayments and Centrelink Advance payments should be required to be included in the 5% cap also).

Further Information Requested: Should a combined cap be introduced that covers both SACCs and consumer leases?

Yes.

Further Information Requested: Would there be any difficulties in determining a combined cap covering both leases and SACCS?

No, we believe a combined cap should be easily determined if the lease or SACC provider is appropriately rigorous in checking consumer bank statements and asking them about their income and expenses. Lease and SACC repayments should be fixed and consistent, and both would generally appear on bank statements, or otherwise be disclosed by a consumer being asked about their regular expenses.

Recommendation

There should be a 5% cap on the percentage of net income that can be committed to repayments, which includes the total amount of repayments made towards any SACC, Consumer lease or Centrelink advance.

OPTION 12: *Prescribe the maximum amount that can be charged on early termination of the contract*

OPTION 13: *Provide a remedy for consumers similar to that in section 78 of the National Credit Code allowing action to be taken for an unconscionable termination charge.*

Further Information Requested:

- What levels of discount on the outstanding lease repayments do lessors provide in their termination clauses?
- Do lessors provide different discounts on the amount attributable to future leases and the charges for future services?

Termination clauses vary considerably but many are punitive considering the fact that the lessee no longer has the benefit of possession of the goods. Given that financial hardship is a common reason for termination, this is a perverse outcome. Financial Rights supports both options above but prefers Option 12 as it is more likely to have a systemic effect than a right to challenge for unconscionability. It has been very difficult to challenge termination fees in EDR schemes, particularly as it is very difficult for consumers to challenge the credit provider's (or in this lessor's) evidence of its losses and administrative costs. There is also no incentive for lessors to take steps to mitigate their losses when they can recover significant amounts from the terminating consumer under the existing contract (in some cases as much or more than would have been charged if the contract had never been terminated.

We suggest a formulation along the lines that termination fees must be:

a. The lessor's reasonable costs incurred by reason of the termination or

b. Two months rental under the contract;

whichever is the <u>lesser</u> amount.

There should be no termination fee payable at all if the consumer returns the goods because they are faulty or have been misrepresented.

Recommendation

Option 12 should be implemented. Termination fee should be the <u>lesser</u> of:

a. The lessor's reasonable costs incurred by reason of the termination or
b. Two months rental under the contract.

Concluding Remarks

Thank you again for the opportunity to comment. If you have any questions or concerns regarding this submission please do not hesitate to contact the Financial Rights Legal Centre on (02) 9212 4216.

Kind Regards,

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