Financial Rights
LEGAL CENTRE

Submission by the
Financial Rights Legal Centre

Senate Standing Committee on Economics

Credit and Financial Services Targeted at Australians at Risk of Financial Hardship

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About the Financial Rights Legal Centre

The Financial Rights Legal Centre is a community legal centre that specialises in helping consumers 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 National Debt Helpline, 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, and the Mob Strong Debt Help services which assist Aboriginal and Torres Strait Islander Peoples with credit, debt and insurance matters. Financial Rights took close to 25,000 calls for advice or assistance during the 2017/2018 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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National Debt Helpline 1800 007 007
Insurance Law Service 1300 663 464
Mob Strong Debt Help 1800 808 488

Monday – Friday 9.30am-4.30pm

Table of Contents

Introduction **4**

Payday lenders and consumer lease providers **5**

The impact of payday loans and consumer leases 5

Payday loans 5

Consumer leases 11

Current regulation of payday lenders and consumer lease providers 15

Reforms to address the harms caused by payday loans and consumer leases 22

Unlicensed financial service providers **24**

The impact of unlicensed financial service providers 24

Buy now, pay later services 24

Current regulation of unlicensed financial service providers 32

Reforms to address the harms caused by unlicensed financial service providers 32

Debt Management Firms **34**

The impact of debt management firms 34

Credit Repairers 34

Money managers 38

Debt Agreement Brokers 41

Debt Negotiation 43

Other debt management services 45

Current regulation of debt management firms 47

Reforms to address the harms caused by debt management firms 48

Debt Repayment Service – a joint industry/community initiative 48

Capacity and capability of the financial counselling sector **51**

Funding of an integrated FC/CLC model 52

Other matters **54**

Pawnbrokers 54

Current regulation of pawnbrokers 56

Reforms to address the harms caused by pawnbrokers 56

Concluding Remarks **57**

Introduction

Thank you for the opportunity to comment on the Economics References Committee inquiry into Credit and Financial Services Targeted at Australians at Risk of Financial Hardship. The Financial Rights Legal Centre will address the terms of reference and provide evidence with respect to the impact and harm relating to:

- pay day lenders and consumer lease providers:
- buy now, pay later services;
- debt management firms including:
    - credit repairers
    - money managers
    - debt agreement brokers and
    - debt negotiators
    - other debt management firms such as paid bankruptcy services and “buy more time’ from home repossession services
- pawnbrokers

Payday lenders and consumer lease providers

The impact of payday loans and consumer leases

Payday loans

Payday loans are loans of up to $2,000 for a period of 16 days to 12 months. These loans attract comparison interest rates of between 407.6% and 112.1%.[1]

Payday loans are marketed as easy-access cash to cover one-off emergencies. In reality, however, payday loans are usually taken out to cover day-to-day living expenses for consumers struggling to pay for daily needs. These loans are designed to create a cycle of dependency for desperate consumers. Repayments are generally direct debited from consumers' accounts on the day wages or welfare payments are received, meaning that people can easily be caught in a harmful cycle of repeat borrowing.

Payday loans are expensive and people become caught in a debt cycle

Obtaining a payday loan can have long lasting negative effects on the borrower's financial well-being. Many consumers become stuck in a harmful cycle of debt. People exhibiting financial stress are increasingly using pay day loans to address short term cash flow problems.

Annualised interest rates for payday loans often exceed 240%. For a borrower already struggling to make ends meet, repayment of these excessive fees and charges can leave the borrower with another shortfall and encourage them to return to the lender.

Research conducted in 2015[2] found that the number of borrowers taking out more than one payday loan in the preceding 12 months has grown from 17.2 per cent in 2005 to 38.0 per cent in 2015. The average number of loans per loan borrower is 3.64. There has been a similar but smaller shift upwards in the number of borrowers with concurrent payday loans.

The purpose that pay day loans are being put towards is also indicative of a debt spiral. The research found that they are increasingly being used as emergency cash for household expenses, such as food, clothing, and medical bills.[3] Payday loans are also being used to cover the costs of internet services, TV subscriptions and phone bills (these are now regarded as essentials, not luxuries) and even borrowing for the purpose of repaying existing loans.[4] Our experience in speaking to clients on the National Debt Helpline is such that we believe the trends identified in 2015 continue unabated.

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[1] Comparison rate calculations completed using RiCalc software assuming maximum permitted fees and charges, and fortnightly repayments. 407.6% comparison rate calculated using a 30 day loan of $200 with total repayments of $248. 112.1% comparison rate calculated using a 12 month loan of $1,000 with total repayments of $1,680.

[2] Digital Finance Analytics and Monash University Centre for Commercial Law and Regulatory Studies, The stressed Finance Landscape Data Analysis, October 2015, http://financialrights.org.au/wp-content/uploads/2015/10/The-Stressed-Financial-Landscape-Data-Analysis-DFA.pdf

[3] Page 18

[4] As above.

Case study 1 –Hayden's story

When Hayden rang the National Debt Helpline in October 2017 he was struggling to pay eight payday loans with seven different lenders. He was on Newstart and working casually while studying to become a teacher, and had been using payday loans to cover living expenses. He ran into trouble when he had to give up his casual work because of mandatory unpaid placements as part of his degree.

One payday loan provider had not actually lent Hayden money as he had not passed their suitability assessment, but had still managed to set up a direct debit on his bank account, resulting in dishonor fees.

Financial Rights raised disputes with every lender individually on responsible lending grounds, and all settled on agreements ranging from issuing refunds to Hayden, to Hayden repaying the principal amount lent in affordable installments, to waiving fees.

C138227

The most vulnerable of people are targeted exacerbating their hardship

We continue to see multiple examples of payday loans being targeted at vulnerable groups, including residents of department of housing estates; women from disadvantaged low income households; women escaping domestic violence; participants engaged in drug and alcohol treatment programs; and people with gambling addictions.

The only available industry data from October 2015 highlights that 44% of the sector's customers are employed suggesting that the rest were not employed.[5] While no specific figures are made available it is clear there are a significant number of customers on benefits.[6] More detailed data, previously made available by the industry but no longer posted publicly online (although available on the Internet Archive) reported that in the 2015/16 financial year[7] that one in four (26.4%) payday loans were given to people receiving the majority of their income from Centrelink; and one in six (16.7%) payday loans were given to customers with an

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[5] Core Data Research, Consumer Credit Industry report, October 2015, http://smallloansbigneed.com.au/wp-content/uploads/2015/10/Consumer-Credit-Industry-Report.pdf

[6] Page 10.

[7] National Credit Providers Association, CoreData Small Amount Credit Contract Research, December 2016, originally available at: http://www.ncpa.net.au/assets/reports/2017/Core%20Data%20SACC%20Report%20Dec%202016.pdf. We note the most recent CoreData research is not available to the public on NCPA's website as at 3 November 2017 and remains offline today. However the report can be found here: https://web.archive.org/web/20180414220546/http://www.ncpa.net.au/assets/reports/2017/Core%20Data%20SACC%20Report%20Dec%202016.pdf

existing payday loan. The average size of a new payday loan entered into was $770, and the average length was 134 days.[8] This is equivalent to a comparison interest rate of 190.2%.[9]

In the second quarter of 2015, three-quarters of payday lenders admitted to providing payday loans to customers who have had two or more such loans in the previous 90 days,[10] despite these loans being presumed to be unsuitable for borrowers under the *National Consumer Credit Protection Act 2009*.[11]

Case study 2 –Anna's story

Anna was a single mother who contacted Financial Rights in March 2017 when she had payday loans with three different lenders. When the loans were granted her sole income was the parenting payment.

Pay Day Lender 1 loaned Anna $1,000 despite her stating she wanted $500. Her application form confirmed she needed the money to pay a debt, but their internal records indicated that she was not obtaining the loan to pay a debt. Pay Day Lender 1 used Anna's gross income rather than net to calculate her 'surplus', and didn't verify Anna's expenses. Anna had paid $1,500 towards this loan, but Pay Day Lender 1 was still chasing Anna for a further $860.

Pay Day Lender 2 provided Anna with a $2,000 loan based on an inadequate online application form, while Anna was paying off an old debt and after Anna had defaulted on her loan with Pay Day Lender 1. There was no evidence that Pay Day Lender 2 had verified Anna's income and expenses. Anna had paid $2,100 towards the loan, but Pay Day Lender 2 was still chasing Anna for a further $1,350.

Pay Day Lender 3 couldn't provide anything to indicate how the $150 loan met Anna's requirements or objectives, or anything to show that they had verified her income and expenses. At the time of the loan, Anna was already in default with both Pay Day Lender 1and Pay Day Lender 2. Anna had paid $380 towards the Pay Day Lender 3's loan, but they were chasing Anna for a further $1,020.

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[8] National Credit Providers Association, CoreData Small Amount Credit Contract Research, December 2016, available at: http://www.ncpa.net.au/assets/reports/2017/Core%20Data%20SACC%20Report%20Dec%202016.pdf.

[9] Comparison rate calculations completed using RiCalc software assuming maximum permitted fees and charges, and fortnightly repayments. 190.2% comparison rate calculated using a 134 day loan of $770 with total repayments of $1078.

[10] National Credit Providers Association, *Submission to the Review of the Small Amount Credit Contract Laws*, 15 October 2015, p. 15, available at: http://www.ncpa.net.au/assets/submissions/2015/NCPA%20Submission%20to%20SACC%20Review%20October%202015%20-%20FINAL.PDF.

[11] *National Consumer Credit Protection Act 2009* s131(3A).

Financial Rights raised responsible lending disputes with each lender, resulting in refunds from two of the providers, write-offs from all, as well as no adverse credit listing and no further recovery action.

C141209

In many of our cases, consumers are provided loans they simply cannot afford to repay. Consumers present to Financial Rights when they are in difficulty. We then analyse their situation to determine whether their difficulties are the result of a change in circumstances or a failure of responsible lending in the initial granting of the loan. For other types of loan, responsible lending breaches are the exception rather than the rule, although some types of credit contract are more likely to reveal systemic lending issues than others. Pay day lending is the only segment where responsible lending breaches are almost invariably the root cause of the problem rather than subsequent changes of circumstances (although these may have exacerbated the problem in some cases).

Case study 3 –Kieran's story

Kieran is 21 years old and has had a drug dependency for 5 years. He had been working and living in rental accommodation until April 2018 this year when he lost his job and was no longer able to afford his rent. Because of his drug dependency Kieran was not able to return home and so became homeless.

In May Kieran applied for and was granted two payday loans of $350 and $500 from two different and well known pay day lenders. At the time of applying for the loans Kieran was still homeless, still had a drug dependency, had no income or savings, was not receiving Centrelink entitlements and had $100 per week to cover essential living expenses.

Kieran clearly could not afford to make repayments and so did not make any. Kieran wanted to improve his life and came to us in October 2018 for help with dealing with his debts. He also entered into rehab. At this time the first loan was with a debt collector for $1,200 and the other with was in default with an amount of $600 being demanded. He had just been granted a Centrelink allowance but would have no income at all for a period because his Centrelink payments would be applied to the costs of rehab.

C175119

For low income and vulnerable customers pay day loans can be very detrimental and the industry's business model seemingly depends on this detriment to survive. According to the research from DFA, the average income of payday borrowers has changed very little over the past 10 years. In 2005 the average income was $35.459 and by 2015 it has only increased to

$35,702[12] which has not even kept pace with inflation. This level of income is still very low compared to the general Australian population where full-time earnings average $75,603 a year.[13]

New demographics are being targeted by pay day lenders

While we see largely Centrelink recipients with multiple difficulties, we are also seeing low income, working borrowers, with problems created rather than exacerbated by pay day lending. The considerable presence of pay day lending in mainstream media, and particularly online, has made it both appear more normalised and able to be accessed anonymously. These loans are now being marketed to a wider audience, irresponsibly suggesting that payday loans can be used to pay everyday expenses like utility bills, rounds of drinks, and presents. This seems to be leading to people who are not in financial hardship to begin with to entering a cycle of harmful debt. Our traditional clients borrow to meet essential expenses when they have a chronic cash shortfall as a result of inadequate income. These more recent lifestyle borrowers start out with stable finances and develop financial problems as a result of their use of pay day loans.

Case study 4 –Larissa's story

Larissa contacted Financial Rights when she had 5 pay day loans, one medium sized loans and a continuing credit contract. Her fortnightly repayments on all of the loans at that time totalled over $1050!

Larissa is employed on a part time contract for 25 hours per week, and her weekly base rate of income before tax is $595. However, in the period before contacting us, Larissa was working a considerable amount of overtime hours which increased her weekly income to up to an average of $1060 per week after tax. While her income was high, Larissa obtained the loans.

As she obtained more loans and her repayments increased, Larissa was forced to continue to accept more overtime hours to ensure that she would be able to afford the repayments, even though she had caring responsibilities for a grandchild. She continued to take out the loans and draw down on the continuing credit contract to supplement her income as she often found that she was not able to meet all her expenses after making the repayments.

As her income fluctuated significantly, and her overtime hours were not guaranteed, she was very concerned about how she would afford to repay the loans if her overtime hours were reduced by her employer.

Even with her higher than normal income, after paying the lenders, Larissa was left with just $520 per week, around half of her income, which was $43.13 below the HPI poverty

[12] Ibid.. Sec 3.5, Table 26.

[13] Average Salary in Australia: http://www.livingin-australia.com/salaries-australia/

line at the time. Without any overtime, her income would only just cover the loans, let alone any living costs at all.

When Larissa sought a credit limit increase from the continuing credit provider, which was declined, she was permitted to extend the time it would take to pay off. At that same time the provider increased her interest rate from 35% to 47%! Her repayment amount did not increase, but the length of time it would take to repay obviously would. They had essentially varied the interest rate precisely when they knew that Larissa was unable to afford to pay more towards the debt, and so would end up paying significantly more interest and take much more time to repay the debt, thus exacerbating her hardship!

Financial Rights requested documents from all of the lenders and raised complaints about unsuitability against all the pay day loan providers involved. We sought a settlement on the basis that they waive all interest, fees and charges on the loans and allow Larissa to repay them by instalments of $50 per fortnight, to each creditor, so a much more affordable $150 per fortnight overall. They all agreed.

C138227

The 2015 research from DFA similarly confirms that there has been a dramatic increase in the number of Australians using payday loans, but also shows that there has been a shift in the mix of household segments using these services.[14] When the population is divided into financially stressed and financially distressed households, with the latter being those in more dire financial straits, payday lending has decreased by a modest 5% in the distressed category since 2010 but exploded in the stressed category.[15] In 2005 around 350,000 financially distressed households were using payday loans, and only about 7,000 financially stressed households. By 2015 the number of distressed households using payday loans has increased slightly to over 375,000, but troublingly the number of financially stressed households has increased almost 40 times to over 250,000.[16] A large proportion of these loans were accessed online.

The explosion in online lending discussed above has serious implications for future growth in the industry.[17] The research states

> *"the increased penetration of payday lending amongst financially stressed households appears to be linked to the rise of mobile technologies and the ease and convenience of online originated loans."*[18]

[14] Ibid. Sec 3.2, Table 11.

[15] Digital Finance Analytics, *The Stressed Finance Landscape Data Analysis*, October 2015. Sec 3.2, Table 11.

[16] Ibid. Sec 3.2, Table 11.

[17] Ibid. Sec 3.1, Figure 7.

[18] Ibid. Sec 3.8, Figures14 and 15.

The use of screen-scraping technology leads to a loss of rights

Many pay day loan providers use third party service providers to access a client's bank account details electronically. This process is called screen-scraping and requires the customer to provide their account and log in details to the third party provider. Two issues arise.

The first is the accuracy of the software is questionable and could lead to significant unintended consequences. The Australian Securities and Investments Commission (**ASIC**) Report 426[19] highlighted concerns in relation to the misinterpretation of account entries via this process, specifically where deposits from other loans (including other pay day loans) were misinterpreted as income. This remains a serious concern. We have recently acted in a matter where a person's National Disability Insurance payment was taken into account as income.

Further customers are placing themselves in breach of the terms and conditions of their transactions account by providing log in details to a third party, rendering them vulnerable to bearing losses in the event of unauthorised access to their accounts.

ASIC Report 426 also noted the inconsistency in approach between providers as to warnings.[20]

Using a consumer's bank statements for any purpose other than what was consented for would be a breach of the *Privacy Act*. Financial Rights also notes that the data that is held by online lenders in rejected applications is on-sold to other lenders willing to take on the risk. According to the Trends in the Australia small loan market report:

> *"One leading online industry stakeholder estimates that the lead-generation market is now larger in Australia than the small loan market."*[21]

The on-selling of the data and details of the most vulnerable segments is incredibly valuable to other debt management firms and pay day lenders who wish to target those people with further advertising for exploitative financial services products targeted at those experiencing financial hardship.

Consumer leases

Consumer leases are agreements whereby consumers make rental payments to a lessor for the lease of goods, generally on a fortnightly basis, over a fixed term, typically between 12 and 48 months,. The consumer has no contractual right or obligation to purchase the goods at the end of the lease term, and even in cases where payments are relatively low, consumers pay significantly more over the term of the lease than the retail price of the goods. Often it is more than they would pay under any other form of credit arrangement.

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[19] ASIC Payday lenders and the new small amount lending provisions March 2015, https://download.asic.gov.au/media/3038267/rep-426-published-17-march-2015.pdf

[20] Page 11.

[21] Banks, Marcus, De Silva, Ashton & Russel, Roslyn "Trends in the Australian small loan market" *Australian Centre for Financial Studies*, *School of Economics, Finance and Marketing, RMIT University*, October 2015, pp. 36-37. Available at: http://australiancentre.com.au/sites/default/files/NewsDocs/Commissioned%20paper%20-%20Trends%20in%20the%20Australian%20small%20loan%20market.pdf

Consumer leases are marketed as granting consumers access to everyday household goods at a low per week cost. However, no lease providers properly disclose to consumers the full cost of making many years of payments for an item that they will not own at the conclusion of the lease. Further, the costs are sometimes so expensive as to be usurious.

Consumer leases are targeted at financial vulnerable Australians.

The customer base for pay day loans and consumer leases is the same – low income, vulnerable customers with few options and often facing multiple challenges (including disabilities, both physical and cognitive; addictions; mental illness; language and literacy problems). We regularly find that our pay day clients also have consumer leases and the consumer lease market appears to have burgeoned since the introduction of the relatively more restrictive 2013 regime for pay day loans, with a significant proportion of the revenue of some large leasing businesses being collected from Centrelink payment via Centrepay.

One particularly vulnerable group that Financial Rights has seen systematically targeted is Aboriginal people in Alice Springs:

Case study 5 – Large Department Store systemic mis-selling

Financial Rights last year acted on behalf of a large number of Aboriginal clients in the Northern Territory following the sale of goods at a Large Department Store via credit card and consumer lease contracts initiated in the store. The salesperson told our clients the goods were cheap, they could pick out anything in the store and it would be sent to them. The sales person did not ask what their income and expenses were and completed the application forms, usually for both a consumer contract and a credit card, without the clients understanding what was happening. All the application forms were filled out by the salesperson and were all completely incorrect. The credit and consumer lease providers involved (both non-bank lenders in this instance) subsequently approved the lease and/or credit cards without verifying the information, or properly assessing the affordability and suitability of the card. The average spend by these consumers was $12,500. Some of them had only entered the shop to browse or purchase a very low value item. These matters have since been settled on good terms with the credit and lease providers involved.

C148716, C139043, C138999, C138324, C138085, C144889, C138850, C149250, C148247, C150556, C150562, C149254, C150560

Consumer lease providers are given access to vulnerable consumers through Centrepay

Financial Rights speak to many consumers who call us because they cannot afford essential expenses such as rent and energy. It is only upon delving into their financial situation that we discover a significant proportion of their Centrepay payments are being diverted to pay consumer leases.

Case study 6 –Georgina's story

Georgina is a 19 year old Aboriginal woman with a history of mental health issues including schizophrenia. She has witnessed domestic violence and the jailing of her father. Georgina had taken out loans with a number of pay day lenders, totaling $850. Her outstanding debts with these credit providers totaled $1,509.90 when she came to us, and her sole income was Youth Allowance.

She also had a consumer lease for a mobile phone, with total repayments over 2 years to be $930.80. The phone was destroyed in a fire at her home a few months after Georgina obtained it, but the Consumer Lease provider were still chasing her for a balance of $674.85.

Financial Rights raised a dispute with all four credit providers regarding responsible lending.

Financial Rights assisted Georgina to settle with all credit providers, with two waiving debts and releasing from all further liability, and two agreeing to allow Georgina to pay the remaining net loan amount in reasonable instalments.

C137143

In some cases our clients are shocked when we calculate the total costs of the lease over the full term. In others, they realise they are being outrageously overcharged compared to the cash price for comparable goods, but felt they had no option if they wanted to have access to goods others took for granted. Unfortunately, these contracts are impacting negatively on their ability to meet other even more essential expenses such as food, shelter and energy.

Remote Aboriginal communities have been targeted by payday lending and consumer lease companies through the use of Centrelink's Centrepay system.[22]

Consumer leases are exorbitantly expensive

Consumer lease providers charge highly inflated prices for their products. The Consumer Action Law Centre's 2013 *Hidden Cost of Rent to Own* Report found that it was common for consumer releases to cost three to five times the retail price of goods, and multiple times the cost of high-cost credit cards.[23]

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[22] "Radio Rentals made $90 million from Centrelink payments last year" ABC, Consumer affairs reporter Josie Taylor, 20 Mar 2015. at: http://www.abc.net.au/news/2015-03-20/radio-rentals-reaps-$90-million-in-centrelink-payments/6333690; "Ongoing probe into appliance rental market" Appliance Retailer, 14 September 2015, available at: https://www.applianceretailer.com.au/2015/09/ongoing-investigation-into-appliance-rental-market/

[23] http://consumeraction.org.au/report-the-hidden-cost-of-rent-to-own/

ASIC's 2015 Report *Cost of consumer leases for household goods* outlined one case in which a dryer cost the consumer, a Centrelink recipient, the equivalent of an 884% interest rate.[24] The report also found wild inconsistencies in the prices charged for goods, both between lessors and by the same lessors to different customer segments. Consumer lease providers routinely charged higher rates to Centrelink recipients, as this was the customer segment identified as likely to pay the higher price, despite having lower incomes and being more financially vulnerable. The report showed that Centrelink recipients regularly paid more than five times the retail price of the leased goods.

The vast variability in the price charged by some providers indicates that pricing is not done in reference to underlying costs and risks, and rather that consumer lease providers are pricing at the highest point they consider they can get away with.

Case study 7 –Matthew's story

Matthew is the primary carer for his 4 children, and suffers from bipolar II, severe anxiety and stress disorders. Matthew does not have a job, but his partner works.

In January 2017 Matthew went to a major retailer with the intention of buying a specific computer he had seen on their website for $900. He had the $900 available in his account. When Matthew arrived at the store, sales staff told him that the computer he had come to buy was 'no good' and convinced him, despite his reservations, to rent a computer (plus some accessories and 'bonus items') valued at $2,800, through a Consumer Lease company. Monthly payments were $223 over 36 months, so the total cost for Matthew would be over $8,000.

In April 2017 Matthew raised his concerns with the Consumer Lease company that he had felt bullied into entering the lease and that he didn't understand the terms of the contract, and requested a hardship variation as he was having trouble making payments. The consumer lease provider told Matthew that if they agreed to the variation this would hurt his credit rating. He didn't hear from them again and he continued making payments until August 2017, by which time he had paid approximately $2,000.

Financial Rights assisted Matthew to lodge a dispute with the Credit and Investments Ombudsman. The Consumer Lease provider offered to release Matthew from any further liability, if Matthew returned the leased items, but no refund. They refused to provide Financial Rights with their suitability assessment which made it difficult to advise Matthew about his prospects of getting a better result from the Ombudsman. Matthew was worried about the time the dispute was taking and the prospect of having to pay a further $6,000 towards the computer and so he accepted the offer.

[24] ASIC, *Cost of consumer leases for household goods* report 447, September 2015, available at: https://download.asic.gov.au/media/3350956/rep-447-published-11-september-2015.pdf

Consumer lease providers often mislead consumers

Under consumer leases, customers have no right to ever own the goods that they are leasing. However, many consumer lessors enter into agreements on the basis that they believe that upon the conclusion of the contract they will own the goods. This belief is generally based on the misleading tactics of sales people, and in some cases, the name of the consumer lease provider or the product itself, e.g. “rent for keeps” or “rent to own”.

This misleading marketing and sales tactic sees many people unable to afford to purchase basic household goods outright pouring vast sums of money into a consumer lease on the understanding that they will eventually own the object, only to find at the conclusion of the contract that they are right back where they started, or that they have to make additional payments in order to own the goods. Consumers are not aware that they are only renting the goods, or that they are not protected by the 48% cost cap that applies to other forms of credit.

Consumers often pay for leased goods beyond the terms of the contract

Many consumer lessors continue to pay for leased goods well after the contract has finished. This exacerbates the already exorbitant expense of the lease and causes further financial hardship. The failure of consumer lease providers to take even minimal steps to clearly and fully inform consumers of their rights and to in some cases actively mislead consumers, makes this problem even worse, particularly for consumers with low literacy.

Consumer lease providers often fail to comply with consumer protection regulation

In our experience, consumer lease providers systemically fail to comply with responsible lending laws. The ASIC Report on consumer leases found that there were significant concerns in this respect, and Financial Rights continues to see poor responsible lending compliance.

Current regulation of payday lenders and consumer lease providers

The *National Consumer Credit Protection Act* 2009 sets out the requirements for small amount credit contracts (pay day loans), medium amount credit contracts and consumer leases.

In summary, pay day loans have the following regulations applied:

- the amount borrowed must be less than $2000
- the term must be between 16 days and 1 year
- the provider can only charge a maximum establishment fee of up to 20% of the amount of the credit and a maximum monthly fee of 4%, charged as a flat rate rather than reducing as payments are made over time
- no establishment fees can be charged where the contract is refinancing another pay day loan
- the consumer cannot be charged more than twice the amount of credit in total

- the provider must assess the consumer can afford the repayments on the basis of reasonable inquiries
- bank statements must be obtained for 90 days
- there is a presumption that the contract is unsuitable if the consumer is already in default under another pay day loan and the consumer has had two or more pay day loans in the past 90 days.
- there must be a warning statement on the providers website
- Centrepay recipients' repayments cannot exceed 20% of the income.

Consumer leases have the following minimal regulations applied:

- Contract terms must be over 4 months
- There is no cost cap
- the provider must assess the consumer can afford the repayments on the basis of reasonable inquiries

These current regulations fall far short of community expectations.

Although Financial Rights has obtained positive results for individual clients using the current credit law, it is a drop in the ocean compared to the number of customers pay day lenders and consumer lease providers have and does little to stem the flow of irresponsible lending

Responsible lending practices (or lack thereof) are failing

The current legislation was intended to ensure that pay day loan and consumer lease providers lend responsibly (in relation to each individual loans) our casework experience is that the legislation has failed. Many payday lenders who ask for bank statements do not look at them very closely if at all, and only retain them in order to later prove compliance with responsible lending obligations.[25] Non-compliance is the norm rather than the exception. ASIC's Report 426 found that lenders are structuring credit contracts to avoid regulation. The report also demonstrates that the presumptions of unsuitability have not effected any real behavioural change in the industry.

People are continuing to repeat borrow

Legislation intended to curb the particular harm created by repeat borrowing has categorically failed to do so. Customers regularly go without essentials, pay consumer leases and pay day loans over other debts, and turn to repeat and multiple concurrent borrowing to feed a cycle of unsustainable debt.

Currently the best way for a pay day lender to determine whether a prospective customer has a pay day loan with another provider or is in default is to look at their bank statements and to simply enquire of the customer. Pay day lenders can also obtain a copy of the customer's credit

[25] 94% of the reviewed filed contained account statements Paragraph 26 REPORT 426: Payday lenders and the new small amount lending provisions, but at paragraph 190-199 found inconsistent approaches and insufficient verification.

report. However, Financial Rights cannot confirm that pay day lenders actually take these two basic steps, and our experience assisting customers with disputes is that providers rarely enquire about a customer's other liabilities or whether the customer is in default on any loans. We have seen several cases where it is apparent on material available to the lender that the prospective borrower has other pay day loans and they either simply ignore the fact or reason it away upon a flimsy basis.

Pay day loan providers appear to conflate the two separate presumptions to the effect that it is OK to have already had two pay day loans in the previous 90 days as long as the borrower is not currently in default.

Laws have not kept apace with technology and new business models

The law has not kept pace with technological developments in the sector and the ability for consumers to access pay day loans and consumer leases over the internet and smart phones. The speed in which a consumer can obtain a pay day loan or consumer is a significant attraction to many, leading to poor and impulsive decision-making in private spaces away from the glare of others or pressure from social norms. They are also advertised in an online environment that is for all intents and purposes hidden from others.

Payday loan lenders often take part in online remarketing and search engine optimisation. Advertisements for instant loans then pop up on the internet and appear in advertising panels on a webpage when a consumer searches for other products from weddings to gambling, making it as easy as possible for people who are vulnerable to overspending or gambling, or already feeling the pinch financially, to close the gap between impulse and action.

Pay day lending has also moved into new demographics, as described above. The introduction of the licensing regime has seemingly lent the industry a measure of legitimacy, which coupled with a large online presence, has seen a measure of acceptance of this type of borrowing among more mainstream populations. The industry also promotes lending for seemingly frivolous purposes – a night out with friends, a party, a phone bill that got a bit out of hand – at odds with all wisdom in relation "good lending" (asset/capacity building) and bad lending ("day to day consumption"). This is directly undermining government initiatives in relation to financial literacy by spreading the opposite messages with a bigger budget and less constraints.

People do not know how much they are paying.

The normalisation process described above is being aided by the fact that small amount credit contract providers are not obliged to disclose their fees and charges as an annual percentage rate (**APR**), meaning that consumers may believe they are being charge 24% per annum when the reality is multiples of that amount.

The DFA report indicates that very few borrowers know the effective APR on their loan and our experience on the National debt Helpline suggests that many borrowers are confusing the 20% per month establishment fee and 4% per month fees with a 24% APR when pay day loans in fact range from about 100% to over 400% depending on the term when charged at the maximum rate and with regular repayments.

This is also anti-competitive as all other lenders in Australia are required to disclose their costs as an annual percentage rate and a comparison rate where applicable.

The current cap on cost provides inadequate protection to consumers.

The current cap on costs has not only allowed the industry to operate, it has flourished at the expense of vulnerable consumers. The use of payday loans among financially stressed households has exploded since 2005.[26] It is clear the competition is not working in this industry as almost every single pay day lender, with only two exceptions[27] we are aware of, charges the maximum cost cap allowed under the law.

Viability of the payday lending industry should not be the starting point of a discussion about cost caps. Ensuring that consumers are able to access safe and suitable financial products should be starting point of this discussion and business viability should be a secondary consideration.

20 per cent of a Centrepay recipient income is too high

The current requirement to ensure that social security recipients pay only 20 per cent of their income in repayments towards pay day loans is one of the few legal requirements that has been complied with by and large. However, 20 per cent of a Centrepay recipient's income is a very generous benchmark. For most of our Centrepay clients more than 80% of their Centrepay is already committed on essentials, plus other obligations. Given the high rate of compliance with this provision it should be strengthened and applied more broadly. We support a limit of 10% of net income (or even 5%) applied to all pay day borrowers, not just those extended to Centrelink recipients.

Payday lending is used on gambling

There are no regulations to ensure that if a payday lenders knows or is reckless as to whether a pay day loan is going to be used for gambling purposes, they should not be permitted to grant the loan.

There are no anti-avoidance provisions

Avoidance practices in relation to the *National Consumer Credit Protection Act 2009* are quite common among pay day lenders in Australia.

As an example of regulatory arbitrage, Cigno Pty Ltd (**Cigno**), together with Gold-Silver Standard Finance Pty Ltd (**GSSF**), operate a business model that effectively avoids the consumer credit protection regime established by the *National Consumer Credit Protection Act 2009*. In short, the scheme operates in the following way:

1. The credit law does not apply to loans if:

[26] Digital Finance Analytics, *The Stressed Finance Landscape Data Analysis*, October 2015. Sec 3.2, Table 11.

[27] Good Shepherd Microfinance's Speckle https://goodshepherdmicrofinance.org.au/services/speckle/ and Credit Corp released a product called Wallet Wizard with a 15% establishment fee and 2% per month fee. Available at: http://www.walletwizard.com.au/costs/

a. the term of the loan is 62 days;

b. the maximum amount of fees and charges provided for under the contract does not exceed 5% of the amount borrowed, and

c. interest is no higher than 24% p.a.

2. Customers are introduced by Cigno to GSSF for the purposes of obtaining a loan.
3. GSSF only offers loans that fall within the exception set out in point 1. Therefore, the Credit Law does not apply.
4. The customer enters into a "services agreement" with Cigno (which is not a loan, and therefore not subject to the Credit Law), under which the customer pays Cigno fees for introducing them to GSSF and "managing" the loan. The service contract is very expensive, and in particular has punitive default fees, far in excess of what a regulated credit provider would be able to charge a defaulting customer under the Credit Law.

Because of this scheme, Cigno and GSSF:

1. Do not have a credit licence or authorised representative status and are therefore:
    a. not in a free external dispute resolution scheme (meaning customers have to take them to court if they have a dispute), and
    b. not subject to the same level of disciplinary oversight by the regulator, ASIC.
2. Do not comply with the "responsible lending" requirement to ensure a customer can actually afford the loan and "service contract" – and as a result, is a lender of last resort, lending to people who cannot get approval anywhere else, and who cannot afford the loan.
3. Are not obliged to offer hardship assistance to customers experiencing difficulty paying their loans.
4. Are not subject to any caps on their fees – this places people into significant debt, whereby a loan of $100-$200, if not repaid plus fees in a timely fashion, quickly becomes a $700-$900 debt and growing.

Case study 8 –Aaron's story

Aaron had three pay day loans from an avoidant Pay Day Lender in the past 6 months. He was unemployed at the time of each loan, with living expenses in excess of his small Centrelink income. He struggles with addiction and schizophrenia. At the time of taking out at least two of the three loans, Aaron was in a drug rehabilitation facility. The avoidant Pay Day Lender sent Aaron repeated marketing emails, offering him "pre-approved" loans, despite having never (as best we can tell) done any assessment of his capacity to repay.

Aaron managed to pay back the first loan (he could not explain how); his dad paid the second one to stop the Pay Day Lender taking money out of Aaron's account (which would have meant he defaulted on his payments to the rehab facility and got kicked out), and the third one was unpaid when Aaron contacted us (through his dad, initially, as he could not make outgoing calls from the rehab centre). In relation to this third loan, Aaron borrowed $200 in May and by June was being pursued for over $700, growing all the time. The Pay Day Lender's avoidance of the *National Consumer Credit Protection Act* 2009 means they do not comply with the restrictions on fees and charges for small amount credit contracts. Not only does the avoidant Pay Day Lender charge more than the permitted 20% establishment fee and 5% monthly fee (calculated by reference to the loan amount) (cf. s31A), the avoidant Pay Day Lender does not limit the amount they seek to recover from defaulting clients to twice the amount lent (cf.s39B) – which is why Aaron's $200 debt more than tripled in a little over a month, and continued to grow.

C167932

Case study 9 –Bill's story

An avoidant Pay Day Loan Lender arranged for Bill, a disability support pensioner, to borrow $200 from another avoidant Pay Day Loan Lender. This loan attracted $160 in fees, in the absence of any default. The avoidant Pay Day Loan Lender's position was that the *National Consumer Credit Protection Act 2009* and its responsible lending requirements and caps on fees and interest did not apply.

Financial Rights drafted a letter for Bill's financial counsellor to send to the avoidant Pay Day Loan Lender raising a dispute and demanding a refund, on the basis that the Act did apply, and that the loan was unsuitable and never should have been granted.

The avoidant Pay Day Loan Lender refunded the full $160 without admission.

C143191

Tellingly another avoidance method adopted by some payday lenders was to adopt a lease structure, for example the Cash Loan Money Centres and Sunshine Loan "leaseback" arrangements.[28]

No restrictions on advertising

Currently there are no specific rules applying to the advertising of the payday lending industry outside of those general rules that apply to all advertisers under ASIC Regulatory Guide 234[29] and the codes administered by the self-regulatory Advertising Standards Bureau.

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[28] http://asic.gov.au/about-asic/media-centre/find-a-media-release/2014-releases/14-278mr-asic-continues-crackdown-on-payday-lending-avoidance-models/

Regulators are not resourced to enforce

ASIC is generally not adequately resourced to enforce pay day loan and consumer lease laws. Enforcement can take many years, and is often reactionary after the harm has been done. Also there is an almost bottomless pit of potential enforcement opportunities, meaning that important issues cannot be pursued because they are not considered priorities.

Having said that, ASIC has boosted its enforcement actions since the Government's response to the Small Amount Credit Contracts Review. They include:

- requiring consumer lease provider The Rental Guys to refund more than $100,000 to vulnerable consumers;[30]
- requiring consumer lease provider Motor Finance Wizard to pay over $11 million in remediation over responsible lending concerns;[31]
- requiring payday lenders Good to Go Loans Pty Ltd and Web Moneyline Pty Ltd to write off and stop offering loans intended to avoid payday lending regulation;[32]
- banning the director of an unlicensed payday lender for three years;[33]
- obtaining a $730,000 fine against payday lenders for a diamond trading avoidance 'sham';[34] and
- cancelling the credit license of consumer lease provider Rent to Own Appliances.[35]

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[29] Advertising financial products and services (including credit): Good practice Guideline: http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-056mr-asic-puts-payday-lending-industry-on-notice-to-lift-standards/

[30] Australian Securities and Investments Commission, *17-243 The Rental Guys refund more than $100,000 to vulnerable consumers*, 20 July 2017, available at: http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-243mr-the-rental-guys-refund-more-than-100-000-to-vulnerable-consumers/.

[31] Australian Securities and Investments Commission, *17-150MR Motor Finance Wizard to pay over $11 million in remediation over responsible lending concerns*, 24 May 2017, available at: http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-150mr-motor-finance-wizard-to-pay-over-11-million-in-remediation-over-responsible-lending-concerns/.

[32] Australian Securities and Investments Commission, *17-343MR ASIC concerns see Good to Go Loans Pty Ltd stop offering loan products*, 12 October 2017, available at: http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-343mr-asic-concerns-see-good-to-go-loans-pty-ltd-stop-offering-loan-product/. See also: http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-344mr-asic-concerns-see-web-moneyline-pty-ltd-stop-offering-loan-product/.

[33] Australian Securities and Investments Commission, *17-336MR ASIC bans director of unlicensed payday lender*, 6 October 2017, available at: http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-336mr-asic-bans-director-of-unlicensed-payday-lender/.

[34] Australian Securities and Investments Commission, *17-060MR Payday lenders fined $730,000 for diamond trading 'sham'*, 10 March 2017, available at: http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-060mr-payday-lenders-fined-730-000-for-diamond-trading-sham/.

[35] Australian Securities and Investments Commission, *16-403MR ASIC cancels credit licence of Rent to Own Appliances*, 23 November 2016, available at: http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-403mr-asic-cancels-credit-licence-of-rent-to-own-appliances/.

Warning statements are ineffective

The warning statements to our knowledge have never been consumer tested. We often receive calls from people who have obtained our number from a pay day loan provider via the warning, however these calls would only represent a tiny fraction of the number of customers that frequent pay day loan providers. Our experience is these callers are often confused about the services we can provide. In most cases, the call is in response to a rejection rather than in response to the warning - that is the consumer is not having second thoughts as to proceeding with a pay day loan transaction or seeking an alternative prior to borrowing.

The most common inquiries are from customers who think we can help them qualify for a payday loan, or some other type of credit.

Some websites have the warning on their home page, right down the bottom near the other legal information. Others do not appear, although possibly does once an application is made.

Reforms to address the harms caused by payday loans and consumer leases

Following a comprehensive consultation period, the Small Amount Credit Contracts Review made 24 recommendations that would provide significant additional protections for vulnerable consumers, and reduce the harm caused by payday loans and consumer leases. The government accepted most of the recommendations in November 2016, and developed the the *National Consumer Credit Protection Amendment (Small Amount Credit Contract and Consumer Lease Reforms) Bill 2017*. The Bill has yet to be put before the parliament by the Government.

The Bill as it currently stands is balanced, proportionate and will prevent many of the worst excesses of both the consumer lease sector and pay day loans. It is imperative that this Bill, which has bipartisan support, be enacted urgently

In the time since the government accepted the recommendations, payday lenders and consumer lease providers have continued to flout the law and harm vulnerable people.

At a minimum, Financial Rights supports the introduction and passing of the legislation however we do not believe it goes far enough and recommend additional measures to more appropriately meet community standards

Recommendations

1. **The Government must move immediately to enact the *National Consumer Credit Protection Amendment (Small Amount Credit Contract and Consumer Lease Reforms) Bill 2017* to:**
   a) **impose a cap on the total payments that can be made under a consumer lease;**

b) extend the existing protected earnings amount for pay day loans to cover all consumers and the portion of income that can be devoted to pay day loan repayments will be 10 per cent of a consumer's net income.

c) Introduce a new protected earnings amount for consumer leases for household goods, whereby lessors cannot enter into a contract that would require a consumer to pay more than 10 per cent of their income in rental payments under consumer leases for household goods.

d) require pay day loans to have equal repayments and equal payment intervals;

e) remove the ability for pay day loan providers to charge monthly fees in respect of the residual term of a loan where a consumer fully repays the loan early;

f) prevent pay day providers and credit assistance providers from making unsolicited invitations to apply for credit and unsolicited credit offers to current or former pay day customers;

g) prevent lessors and credit assistance providers from undertaking door-to-door selling of leases at residential homes;

h) introduce broad anti-avoidance protections to prevent pay day lenders and consumer lease providers from circumventing the rules and protections contained in the *National Consumer Credit Protection Act 2009*; and

i) strengthen penalties to increase incentives for pay day providers and lessors to comply with the law

2. In the alternative If the Bill is not enacted, the Government should abandon the fee regime and simply introduce a comprehensive cap of 48% interest for all forms of credit;

3. Moving forward the government must consider the following:

   a) remove consumer lease providers from Centrepay altogether;

   b) ensure pay day lenders disclose the cost of the contact as an APR

   c) extend the proposed Design and Distribution Obligations and Product Intervention Powers to pay day loan and consumer lease providers;

   d) strengthen advertising restrictions as they apply to pay day loan and consumer lease providers;

   e) introduce rules regulating the use of pay day loans for gambling purposes.

Unlicensed financial service providers such as ‘buy now, pay later’ providers and short term credit providers

The impact of unlicensed financial service providers

Buy now, pay later services

Buy now, pay later providers claim to offer zero-interest financing for goods, avoiding regulation under the *National Consumer Credit Protection Act 2009*. However, this model simply hides the cost of finance under the guise of “fees” for providing a service.[36] We see many cases of products being sold with a claim that they are zero-interest, where the price of interest is in reality just built into the retail price of the goods - the value of the goods being purchased often significantly less than the amount being borrowed by the consumer. Consumers are effectively charged extra fees with this form of credit, without being protected by responsible lending obligations or access to external dispute resolution.

Buy now, pay later services make it easier for people to fall into debt

Buy now, pay later services make it easier for people in debt to fall into yet more debt, as people who may be rejected by other regulated credit providers can indebt themselves more easily to these unregulated providers since they do not have to assess a person’s ability to repay under responsible lending laws.

Buy now, pay later services therefore carry out few if any inquiries of consumers' financial situations prior to providing credit, and some providers fund high purchase costs (up to $30,000) over long repayment periods.

Currently late fees make up a substantial proportion of a buy now pay later provider’s income. Afterpay, for example, reported that $28.4 million or 24% of its income in the 2017-18 financial year is made up of late fees. And this is increasing – with a 365% surge from the $6 million worth of late fees from the 2016-17 financial year.

There is therefore a financial incentive to irresponsibly lend and offer credit to people who will be unable to make payments on time. These late fees, when charged to consumers already in debt, only exacerbate the problem.

Buy now pay day services add to the debt spiral

Our financial counsellors report never seeing a buy now, pay later debt as the sole debt causing a problem that requires intervention from a financial counsellor – rather they are one of many forms of debt that they are seeing.

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[36] For example, see Joyce Moullakis, Former Macquarie manager Katherine McConnel looks to shake up energy finance, 10 October 2016. Available at: http://www.afr.com/business/banking-and-finance/former-macquariemanager-katherine-mcconnell-looks-to-shake-up-energy-finance-20161007-grxl2x; Financial and Consumer Rights Council, Afterpay: what you need to know, 8 February 2017. Available at: http://www.fcrc.org.au/membernews/afterpay-what-you-need-to-know

In a recent survey of consumers 65% believed small digestible payments were influencing them to make purchases they would not normally make.[37] 30% said they had missed at least one Afterpay payment, 30% of those surveyed admitted to having concealed their Afterpay spending from a partner or parent. The survey also found that men were generally faring worse than women when it came to bad Afterpay habits, as were younger users.

The debts may also impact upon a person's credit history, making things worse for them. [38] According to the Mozo survey, 36% of respondents weren't aware that buy now pay later services could have an impact on their credit rating.[39]

Buy now pay later services increase the costs of goods for all consumers not just those who use the service

The majority of revenue for buy now, pay later services was derived from fees paid by retailers and merchants. However this means that costs are simply covered by increasing the price of goods across the board passed on to all buyers. As Saurav Dutta[40] has explained this is traditionally called factoring of accounts receivable:

> *This is when a company sells its accounts receivables (money owed for a good or service that has already been delivered) to a lender, typically at a discount.*
>
> *Typically, factoring arrangements are between a business and a lender, with the customer being oblivious to the arrangement. Afterpay's innovation was to turn this centuries-old, back-office financial arrangement into something customer-facing.*
>
> …
>
> *An example of traditional factoring would be a company selling A$100 in accounts receivables to a lender for A$95. The company gets A$95 cash up front (to spend on wages or ingredients) and eliminates the risk of not being paid. The lender makes a A$5 profit once the A$100 has been collected.*
>
> *Similarly, if you make a A$100 purchase using Afterpay, the merchant immediately receives A$96. Afterpay then collects four instalments of A$25 from the customer, making a A$4 profit.*

Dutta then recommends that:

> *Customers making cash or credit card purchases may soon demand that online merchants give them a 4% cash discount – the same amount they pay Afterpay.*

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[37] Mozo, Australia's Afterpay Obsession: A report into the features, buying habits and traps of the modern day layby https://mozo.com.au/credit-cards/guides/australia-s-afterpay-obsession-a-report-into-the-features-buying-habits-and-traps-of-the-modern-day-layby

[38] Afterpay, for example, says that it does not currently report overdue borrowers to a credit reporting bureau, however they reserve the right to do so in their terms and conditions. We are unsure about the current practices of other buy now pay later services.

[39] As above. And https://www.afterpay.com/en-AU/terms-of-service " Afterpay reserves the right to report any negative activity on your Afterpay Account (including late payments, missed payments, defaults or chargebacks) to credit reporting agencies."

[40] Saurev Dutta, Explainer: how lending startups like Afterpay make their money, The Conversation, 7 December 2017 https://theconversation.com/explainer-how-lending-startups-like-afterpay-make-their-money-86477

Buy now, pay later services are exempt from hardship arrangement obligations

As buy now, pay later services fall outside of the auspices of the *National Consumer Credit Protection Act 2009*, they remain free from the obligation of a lender to enter into hardship arrangements with clients who fall into financial trouble.

Even for smaller amounts of a few hundred dollars, people risk damage to their credit report if they are unable to repay in accordance with the terms. For larger amounts into the thousands of dollars, this risk can be devastating.

Consumers easily avoid the minimal rules in place creating further problems for themselves

Financial counsellors have found that those with debts usually have a lot of buy now, pay later debts and usually hold multiple accounts. Afterpay has claimed that "Customers cannot continue to use the system if they are overdue on any payment."[41] However if a consumer defaults on the payments on one account and become barred from using the service, they simply avoid this prohibition by simply creating new accounts with new email addresses. The ease of joining the service with few checks means that people are getting themselves into more and more debt, beyond the ostensible limits placed on the accounts.

To complicate matters, the debt listings on a consumer's own bank accounts look identical making it very difficult to know which debt is which and how many debts there are.

***Consumers are unable to easily align buy now, pay day later debts to their pay day*.**

Unless a consumer purchases a good on their pay day there is no way to adjust payments to fall on a pay day – a common way to ensure that someone can cover their debts and avoid any default payments. Consumers are incurring direct debit dishonor fees as a result of their buy now pay later payments no aligning with their pay period.

Consumer data is being on-sold to other debt management firms and credit providers

Consumers are reporting that they are seeing an increase in spam from financial service providers once they use a buy now, pay later service. We note for example that Afterpay states under their privacy policy that they share data with "Financial institutions that we may partner with to jointly create and offer a product."

There are no regulations on to prevent this.

When people get in trouble there is nowhere to go

There is no compulsion for an Internal Dispute Resolution process to be place or be a member of an External Dispute Resolution scheme.

People are simply locked out of their accounts and can't even access their account to figure out what is going on and how much they owe.

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[41] https://www.abc.net.au/news/2018-08-24/afterpay-late-fees-24pc-income-asic-loophole-credit/10156902

Case study 10 –Ursula's story

Ursula contacted Financial Rights to make a complaint about a Buy Now, Pay Later service. Ursula signed up to the Buy Now, Pay Later service to purchase a number of items before Christmas, while she was on Centrelink. Several months later she was struggling to meet the payments.

Ursula thought the Buy Now, Pay Later service had a system where it assessed what she could afford: she had used it once before and at that time there had been a limit on how much she could spend. After Christmas Ursula saw she owed $550 from several different retailers and had already missed two or three $20 payments from some retailers, and some $50 payments from others. She thought some late fees had also been added but was not sure.

The Buy Now, Pay Later service then locked Ursula out of her account entirely, so she was unable to check what was owed. Ursula's only form of income was Centrelink, she was already paying back a $400 loan through Centrelink, and she and her partner both had other loans and bills. When she applied for hardship through the Buy Now, Pay Later service she was told they would charge no further late fees and that her account would be put on hold.

Ursula's Buy Now, Pay Later service debt was passed along to debt collectors, who continued to add fees to the amount owed. The collectors would not tell Ursula exactly how much she owed for some time, until they eventually told her the debt was $1,323.42. This was far higher than the total initial purchase amount, and included significant late fees, added after Ursula was assured that there would be no further late fees.

Financial Rights assisted Ursula to gain a waiver from the Buy Now, Pay Later service on over $500 of late fees, and to negotiate a payment plan of $30 per fortnight for the principal amount borrowed, plus $47 in late fees incurred before Ursula contacted Buy Now, Pay Later service regarding hardship.

C159719

Case study 11 –Jerome's story

Jerome owes an unknown amount on his Buy Now, Pay Later service account. Jerome had made arrangements for payments to be direct debited from his Mastercard, but after one successful payment, Jerome had to cancel his Mastercard because of unrelated unauthorized payments on the card.

Jerome tried, unsuccessfully, to contact the Buy Now, Pay Later service, but is still unable to reach them.

A second payment was processed through Jerome's bank account, overdrawing the account. Jerome's bank was unable to explain why the Buy Now, Pay Later service transaction was processed when his card had been cancelled and there was no authority on file to take payments from Jerome's bank account. The bank told Jerome it thought the payment was made "offline". Jerome is concerned the Buy Now, Pay Later service will take more funds while he is unable to reach them to change payment details.

C161398

There is nothing preventing children from using the service

There are no restrictions in place to ensure that minors are unable to use buy now, pay later services. Fairfax recently reported on minors using payments to "buy up to $300 of alcohol while an account registered to "Mickey Mouse" spent $250 on wine and other goods."[42] In this example, not even the most basic of checks were conducted into contradictory information provided.

Case study 12 –Liz's story

Liz applied for a Buy Now, Pay Later service in January 2017 to purchase goods at Retailer 1. At the time she was aged just 17, a student, and was working between one and two days per week at Coles, earning $100 per week. After having partially paid off her purchase at Retailer 1, in May 2017, Liz used the Buy Now, Pay Later service again on Retailer 2's website to purchase a watch and some other goods, which totaled $400. Liz was then involved in a car accident and no longer working, and so she contacted Financial Rights.

Liz's mother has helped to pay some of Liz's Buy Now, Pay Later service debt, but Liz's mother is unemployed and has little capacity to continue to help. The balance owing on Liz's Buy Now, Pay Later service account is approximately $280, and she knows she is attracting late fees each time she fails to pay. Liz is struggling with several other debts

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[42] Jonathan Shapiro, Afterpay forced to act on under-age alcohol buying after Mickey Mouse report, AFR, 4 April, https://www.afr.com/business/banking-and-finance/financial-services/afterpay-forced-to-act-on-underage-alcohol-buying-after-mickey-mouse-report-20180403-h0yame

including damages from the car accident and has no capacity to pay off her Buy Now, Pay Later service debt.

At the time of Liz's application for Buy Now, Pay Later service, the form only asked her for personal details such as name, address and phone number. There were no questions regarding employment or income.

C159145

Buy now, pay later services are being pushed by retailers and in door to door sales

Financial Rights has dealt with a number of cases where door to door sales people are selling services like solar panels and roof repairs and securing contracts to purchase using buy now, pay later services. The use of these services to help sell the original product is confusing to many leading many financially vulnerable people subject even more vulnerable to exploitative unsolicited sales tactics.

Case study 13 –Paul's story

Paul, a disability support pensioner, was sold solar panels by a Solar Panel door-to-door salesperson in June 2017. To pay for the panels, Paul signed up with a Buy Now Pay Later service.

The solar panel system never worked properly, and caused dangerous power surges, destroying Paul's fridge and heater. Paul attempted to resolve the matter with the Solar Panel company and with the Buy Now Pay Later service, including through NSW Fair Trading, but got nowhere.

Financial Rights raised disputes with both the Solar Panel company and with the Buy Now Pay Later service. We were unable to argue any points relating to responsible lending under the Credit Protection Act, instead we had to argue on Consumer Law provisions dealing with consumer guarantees, protections in relation to unsolicited consumer agreements, and linked credit provisions.

The Buy Now Pay Later service ultimately agreed to refund Paul the $1,500 he had paid to date, released him from further liability under the contract, and let him keep the solar system.

C163425

More broadly though Financial Rights understands that there are an array of Buy Now Pay Later services targeted at specific expensive goods and or/services, whereby extending their credit like service reach into areas that would normally be covered by credit rules.

Case study 14 –Diane's story

Diane is a 66-year-old widow who is legally blind in one eye and relies on the Disability Support Pension as her only income.

In March 2017 Diane needed extensive repairs to the roof of her home, and entered into two contracts with a Roof Repairer. The first contract was for $1,850, did not involve any financing, and was signed by Diane's son. The second contract was for $17,600, with $11,000 financed by a Buy Now, Pay Later service. Under the separate contract with the Buy Now, Pay Later service, Diane was to make fortnightly repayments of $131.52 by direct debit.

Diane said the Roof Repairer told her the total cost of repairs was $3,000. Diane was not aware at the time that she was signing multiple contracts. She did not understand the total cost, she cannot remember being asked to sign a second or third contract, and was not aware that the second contract involved third party finance. Diane was not asked about her financial situation before signing the Buy Now, Pay Later service contract, nor was she asked for documentation regarding her Pension.

C150542

Case study 15 –Denise's story

Denise has been receiving credit and debt advice from Financial Rights since 2015. She suffers from a brain injury and is on the DSP.

In March 2018 she called Financial Rights regarding a debt owing to a Dental Care Buy Now, Pay Later service following some dental work she had been able to get done. The Dental Care Buy Now, Pay Later service is specifically designed for dental and orthodontic services. It charges no interest and advertises itself as using:

> *No complicated finance contracts to complete. No credit checks and no lengthy approval process are required. Start your treatment straight away. Now there's no reason to delay that perfect smile. Don't pay any interest on your dental or orthodontic treatment. No interest, no fuss as no interest involved.*

Denise told us the payments she was required to make were $197 a fortnight through direct debit, which would leave her with $30 left to spend on living expenses. She did not have enough money in her account to make payments and began to be harassed by debt collectors.

Financial Rights advised Denise that the a Dental Care Buy Now, Pay Later service does not have to follow responsible lending obligations because they don't charge interest and fall outside consumer credit laws..

S199047

Case study 16 – Rob's story

Rob is over 70 and his only source of income is a pension. In July 2016, a salesman from a Solar Panel Provider approached Rob's house selling solar panels. Rob advised that he already had solar panels, but two days later the salesman returned with an agreement and information on how Rob could fund the purchase of extra panels worth $8,500.

Rob was told there was enough space on the roof of his shed to put more panels, and that instead of paying $120 a month to the electricity company, he should pay $99 a fortnight for the solar panels for savings in the long term. He was told that a Buy Now Pay Later service would give him an interest-free loan to pay for the panels, and direct debit the money from his account.

Three months later, Rob had saved only $30 on his electricity bills and could not afford the repayments to the Buy Now Pay Later service.

C137671

Case study 17 – Eden's story

Eden is 65 years old, lives in public housing, and is on the aged pension. She has severe back pain stemming from an injury in 1995.

Eden saw an ad on Facebook for a reclining chair and contacted the Reclining Chair company to enquire. She was told that as she was on the aged pension they would not do any background checks on her. A few days later, the chair arrived, and Eden was asked to sign what she thought was a delivery receipt. No copies of the documents were given to her.

The next day, Eden called the Reclining Chair company to say that she could not sit in the chair as it exacerbated her back pain, and that she wanted to return it. The Reclining Chair company said that she could not return it, only exchange it for a bed, which Eden did not want.

A few days later, Eden received the Buy Now Pay Later contract in the mail that she had unknowingly signed. The cost of the chair was $4,500 and Eden had to pay weekly amounts of $128. She could not afford this so her niece started paying for the chair, and got in touch with Financial Rights.

C140396

Current regulation of unlicensed financial service providers

Buy Now Pay Later services are not specifically regulated as they do not fall within the auspices of the *National Consumer Credit Protection Act 2009*. This means that there are no requirements for:

- responsible lending checks
- internal dispute resolution
- external dispute resolution
- access to financial hardship arrangements

Many 'buy now pay later' providers have placed self-imposed limits on how much a consumer can spend, but these are purely voluntary and there is likely to be shareholder pressure to increase these limits. There is therefore no guarantee that these self-imposed rules will remain, or other services will provide limits at all.

As buy now, pay later services grow, pressure is likely to grow and spending limits will likely increase. Further, there is every possibility that other start-ups will step in and have much higher spending limits. Both of these eventualities will significantly increase debts incurred by consumers.

Reforms to address the harms caused by unlicensed financial service providers

At a minimum, the *National Consumer Credit Protection Act 2009* must be expanded to ensure that all buy now pay later services are required to be licensed and are subject to the same requirements as all other credit providers. Currently to get the *National Consumer Credit Protection Act 2009* to apply it needs to be proved that the cost is more than the cash value of the goods. This is increasingly difficult to achieve with goods, that are own brand or not easily comparable. Consumers are not willing to take the risk to test the matter in Court, and many buy now, pay later providers resolve the issues before it can be tested when the issues are raised

In addition to this the law to be expanded to address a number of the unique aspects of these services including regulating:

- late fees;
- multiple accounts;

- ensuring appropriate identity checks;
- prevent locking users out of accounts;
- restricting the use of these services by minors

There needs to be broad and strong anti-avoidance rules put in place to ensure that any new business models that pop up that evade the regulatory regime captures these businesses.

The proposed Design and Distribution Obligations and Product Intervention Powers must also be applied to buy now pay later services.

Recommendations

4. **At a minimum, the *National Consumer Credit Protection Act 2009* must be expanded to ensure that all buy now pay later services are required to be licensed and are subject to the same requirements as all other credit providers including internal dispute resolution and membership of AFCA.**
5. **In addition to this the law to be expanded to address a number of the unique aspects of these services including regulating:**
   a) **late fees;**
   b) **multiple accounts;**
   c) **ensuring appropriate identity checks;**
   d) **prevent locking users out of accounts;**
   e) **restricting the use of these services by minors.**
6. **There needs to be broad and strong anti-avoidance rules put in place to ensure that any new business models that pop up that evade the regulatory regime captures these businesses.**
7. **The proposed Design and Distribution Obligations and Product Intervention Powers must also be applied to buy now pay later services.**
8. **Ensuring the buy now pay later industry is subject to a Code of Practice (in addition to strict statutory rules) to increase standards of practice in the industry similar to the role played by current codes of practice in the sector.**

Debt management firms, debt negotiators, credit repair agencies and personal budgeting services

Debt management firms generally offer to help and improve a person's financial situation through any number of ways. Debt management firms include:

- credit repair repairers - who claim to fix a consumer's credit ratings
- money managers - who charge to manage income, bills and debts
- debt negotiators - who present debt negotiating as something they do as a "professional'
- debt agreement brokers - who direct people into Part IX debt agreements – a form of insolvency
- other debt management services including paid bankruptcy services.

The impact of debt management firms

Credit Repairers

Credit Repairers claim that they will be able to "fix" or "clean" a bad credit report and "improve" poor credit score. They claim that they are able to help a consumer by updating and removing any "black marks" on their credit report. However their ability to do any of this is limited and if a consumer's credit report is inaccurate they can get it fixed for free.

People are paying for a service they can do themselves, through an ombudsman, financial counsellor or community legal service

The only entries on a credit report that can be removed are those that:

- are proven to be factually incorrect (money was not owed, debt belonged to a different person, payment was actually made on time);
- procedurally incorrect – the consumer was not given the correct notices required by law before the listing was made: or
- disputable for another reason (such as that the loan was unjust or made in breach of responsible lending obligations in the first place).

Consumers have the right to request a free credit report and can speak directly with a credit reporting bureau or their creditors to remove an incorrect listing. A default listing cannot be removed just because it has been paid, although it can be updated to note that it has since been paid.

Case study 18 –Farhad's story

Farhad is an Iranian refugee who had been held in an Australian detention centre before being granted permanent residency and Australian citizenship. He has very low English literacy. He had previously had billing problems with a phone, which he had managed to settle himself.

Farhad engaged a Credit Repairer when he became aware of a default listing on his credit report from the Phone Provider. The Credit Repairer said that Farhad had to pay a balance of $529 to the Phone Provider in order to have the default listing removed. Following this, the Credit Repairer then aggressively pursued Farhad to pay almost $2,000 in admin and success fees.

Farhad approached the Phone Provider and managed to have the default listing removed by himself, but continued to be harassed by the Credit Repairer. Financial Rights wrote to the Credit Repairer asserting Farhad's position, but the Credit Repairer recommenced debt recovery without telling us, despite knowing that we were acting on his behalf. The Credit Repairer emailed and called Farhad, and even recommenced a direct debit on his account, leading to overdraw fees. Financial Rights wrote to Farhad's bank requesting a chargeback and that the bank put a bar on the Credit Repairer.

Financial Rights obtained Farhad's account notes and history of dealings with the Phone Provider, which confirmed Farhad's position. We wrote to the Credit Repairer with these notes and asking for a full refund. The Credit Repairer counter offered to refund $80 and release Farhad from further liability, to which Farhad agreed.

SC153069

The people who sign up with credit repairers are those who can afford them the least and they entrench financial hardship

People in financial hardship and looking to improve their credit report are those who can least afford a service that provides little to no value.

The high upfront fees – sometimes thousands of dollars - are usually non-refundable, even if it turns out the credit report cannot be changed. Credit repairer contracts can also include vague wording to ensure they can charge client's an extra success payment – such as that they can charge for *any* change to a credit report, even if the change is insignificant such as a minor adjustment to the amount outstanding. Fees may also be payable per listing removed leading to many clients incurring high fees for multiple listing without any improvement to their ability to maintain credit. Credit repairers are reluctant to publicise fees and often impose unexpected late payment, cancellation or other administrative fees.

Case study 19 – Eliza's story

Eliza is a 23 year old single mum whose sole income is the Centrelink parenting payment. She receives $1,200 a fortnight from Centrelink and pays $700 of that on rent, leaving her with just $250 a week for living costs for her and her child.

In September 2017 Eliza tried to have electricity connected at her new house, but was declined as her previous provider had listed a default on her credit report. Eliza contacted a Credit Repairer for help to remove the default, which she says was incorrectly listed, and entered into a contract with a Credit Repairer with weekly repayments of $80 per fortnight. She quickly realized she could not afford the payments on her Centrelink income, and direct debits to the Credit Repairer were being immediately rejected due to insufficient funds. When Eliza asked to cancel, the Credit Repairer told her that although they hadn't done anything other than issue the contracts, if she cancelled she would still have to pay the $1,089 admin fee.

Financial Rights argued to the Credit Repairer that they had engaged in misleading and deceptive conduct by telling Eliza that she would not be able to have the default listing removed without their assistance, and that they did not exercise due care and skill and the product was not fit for purpose as it would put her in hardship. The Credit Repairer agreed to waive the admin fee and other outstanding fees, on the basis of financial hardship, without admission about the other issues.

C153215

People's individual circumstances are not taken into account

Credit repairers frequently make promises and guarantees without properly considering the individual circumstances of the consumer. This cookie cutter approach can lead to poor outcomes for individual clients.

People are charged for little to no-service at all

Some credit repairers only supply clients with written guides and expect them to do the whole dispute process themselves self. All of the information provided is available elsewhere for free.

Case study 20 –Lucy's story

Lucy went to a Credit Repairer in to remove a default listing. She agreed to pay $2,200: half as an administration fee and half as a success fee. The Credit Repairer negotiated with the Telco, who agreed to remove the listing if Lucy paid the full $1,500 owing to Telco within a reasonable time. However, it was left to Lucy to negotiate repayments. Lucy was working at the time but had many debts. When she contacted the Telco she was told the debt had been sold to a debt collector, who refused to remove the listing regardless of a repayment agreement.

2 years later the debt to the Credit Repairer had grown to $7000 as they had continued to direct debit her account unsuccessfully every 3-4 days and added a $50 dishonour fee each time.

Financial Rights assisted Lucy to make a complaint to the EDR scheme. The phone recording of Lucy's initial conversation with the Credit Repairer established that Lucy was promised a full refund after 12 months if the listing could not be removed. It also showed that Lucy had never been provided terms and conditions for her contract.

C133650

Case study 21 –Salim's story

Salim is a single father and his main source of income is driving Uber, where he earns between $1,000 and $1,500 per week. His first language is Arabic and he does not read or write English well.

Salim signed up to a Credit Repairer as he had a default listing on his credit file and was concerned about his credit rating, which was 59 at the time, impacting his ability to secure finance in the future. The Credit Repairer charged $1,100 in administration fees plus $1,100 if the default was successfully removed. The Credit Repairer's salesperson told Salim that most people need a credit score of 600-650 in order to obtain credit, that they could remove his default and give his score a massive boost, enabling him to apply for credit.

Salim started making payments towards the Credit Repairer's fees, and they did remove the default listing, but Salim's score did not improve to the level that he was led to believe it would and he could still not get credit.

C144321

Credit repairers misuse the external dispute resolution scheme

Credit repairers regularly use aggressive tactics to get creditors and credit reporting bureaus to remove legitimate listings, which harms the integrity of the credit reporting system. This often takes the form of threatening to take the creditor to an external dispute resolution scheme, where the creditor must pay for each dispute lodged. The Credit and Investments Ombudsman (**CIO**) has previously estimated that a third of complaints about incorrect credit reports originated from credit repairers and Energy and Water Ombudsman NSW attributed 25% of its cases to credit repairers. The complaints are often ill prepared, lacking in foundation, may not match the client's actual circumstances, and the issues are drip fed so that as the scheme excludes one ground of complaint another is added to draw out the dispute. This conduct led to strict policies being developed at CIO, the Financial Services ombudsman (**FOS**) and now adopted by the Australian Financial Complaints Authority (**AFCA**) to respond to the problem.

Credit repairers open consumers to other negative consequences

Some credit repairers tell people to file documents in court, exposing them to potential adverse consequences like costs orders. The following case study is an example of this and also an example of how difficult is to seek justice against a debt management firm

Case study 22 –Ian's story

A Credit Repairer promised Ian that they would remove a judgment (paid) from his credit file. They told Ian that their "services" involved sending him a booklet (which consisted of pages downloaded from various Ombudsman sites about lodging a dispute). Ian paid $1100 for their services.

The Credit Repairer told Ian to file a Notice of Motion in court seeking a discontinuance of the proceedings (even though he had no basis for doing so). They completed his court paperwork using a pro forma document (that was incorrect) and told him what to say at court. The judgment creditor also attended and sought costs from Ian. Luckily the Registrar saw through everything and awarded no further costs, and told Ian to call us. He did not set aside the judgment.

The credit repairer was not a member of EDR. After failed attempts at negotiation, Ian lodged in the NSW Consumer and Administrative Tribunal against the credit repairer. Ian attended the first directions hearing by telephone and felt intimidated by the Tribunal Member who was pushing for him to settle for a lesser amount. Ian refused, and Ian, with Financial Rights help set about preparing the copious material requested from the Tribunal (i.e. including using a mandatory white folder of evidence) for the hearing. Financial Rights was not successful in seeking leave to appear at the Tribunal. During this process, Ian got tired of it all and asked us to settle for a previously offered amount. The Credit Repairer paid, though for Ian this did not feel like a win.

C116794

Money managers

"Money Management," "Personal Budgeting Services", or 'Debt Payment Services' offer to manage a client's income to ensure the payment of bills and debts, while providing the client with an allowance for daily expenses. Some will also claim to provide other services, such as promising to review the client's financial position on a regular basis and negotiating future repayment arrangements with your creditors. In managing the payments, they often charge periodic 'maintenance' or management fees. This is often in addition to up-front 'establishment' fees charged to set up accounts with them.

People are not left with enough money to live on

Callers to Financial Rights also complain that they are not left with enough money to live on, as Jack and Annie are in Case Study 21 where they were left without enough money to buy nappies, food and petrol or that their priorities are not taken into account in the payment of bills. A person reported to Financial Rights getting an eviction notice as their rent was being paid.

Case study 23 –Annie and Jack's story

Annie and Jack are Disability Support Pensioners, they both have intellectual disabilities and Jack suffers from Anxiety and Depression. They have 3 children, including a 10 month old and reside in rural NSW. After seeing 2 free financial counsellors, who both advised that they were in a deficit in their money plan Annie and Jack responded to an advertisement on the television for a budgeting service. Annie and Jack attended for a 3 hour meeting. When telling the consultant of the free financial counsellors advice, they were advised "well, that's the hard thing about those places and sometimes you need to pay to get a little something worthwhile out of it" Annie and Jack were signed up to a service costing $3,000 for the first year, an establishment fee and a weekly service fee. Jack was a bit hesitant, but they told him they might refinance his mortgage in the future. Jack agreed. The service worked, by requiring Jack and Annie to pay their income to the service provider, and Jack and Annie believed they would be paid $325 per week as their allowance. They believed all their bills would "taken care of" They believed at the end of the year, they would have a savings plan for Christmas expenses.

However, the agreement they signed up to did not result in all their bills being paid. Some of their bills still needed to be paid by Jack and Annie, and the funds would be paid into their account along with the $325 per week. The $325 was manifestly insufficient as it did not take into account Jack's travel costs to see his Sydney based doctors, or sufficient nappies for the children. The budget did not include some of the debts Jack told them about, so he kept getting hounded. Many of the debts went unpaid, they were confused as to how it worked and their car and home insurance lapsed. They were given no real assistance in learning how to reduce their expenses to $325 per week and could not realistically do so.

Jack and Annie returned to a financial counsellor to assist clean up the mess.

C115604

Case study 24 –Mark's story

Mark had a number of debts he was behind on – two loans secured over his car, a loan for a TV, a number of pay day loans and a personal loan. He went to a personal budgeting service in late 2016. They charged an establishment fee of $1,900, weekly administration fee of $30. A budget developed for Mark based on living expenses other than housing of $140 week. The Henderson Poverty Index amount for after housing costs for a person in his circumstances at the time was $350. The budget was based on reduced repayments that had not yet been negotiated with the creditors. Mark's shifts were cut at work. The budgeting service told him "you need to find more income". The budgeting service prioritised payments under a consumer lease for the TV, and paid out a pay day loan in full in preference to the loans secured over his car. Mark called National Debt Helpline when he got a default notice on his car loan and was at imminent risk of having it repossessed.

C142285

People's monies are at risk

Money managers hold and manage money without any regulatory oversight or any client. Where a company only provides money management or budgeting services there is no requirement for them to hold an Australian Credit or Financial Services license and as such, there are no requirements or laws that apply to their handling/holding of client monies

In other words there are no rules about whether your money is separated from the businesses' money. If the business was to cease trading, the client is likely to be unable to recover their funds prior to any creditors.

We note, for example, in Financial Rights' class action against My Budget, client funds were pooled together so that it was not possible to "to identify with any precision the proportion of client interest that has been contributed by specific client's funds."[43] With no rules in place to ensure that client funds are kept separate and held in trust, it is inevitable that significant problems will arise.

People are at serious risk of default and deteriorating credit histories

Money managers generally keep the interest earned from a client's account. This can lead to a potential conflict of interest, where they may be more likely to keep the money in the account for as long as possible to accrue interest, instead of paying debts when they fall due. This can impact upon a person's credit history, their savings and places people at risk of default.

There are also misunderstandings with respect to the level of management a client will receive. Money managers often take no responsibility for dealing with creditors if there is not enough money in the account to pay all your bills. Some people report being sued or having their goods repossessed when they thought their affairs were being managed. Others are open to

[43] Turner v MyBudget Pty ltd [2018] FCA 1407, 18 September 2018

enforcement proceedings and impaired credit where there is insufficient income and bills go unpaid.

Case study 25 –Ben's story

Ben is 56 years old and has a cognitive disability. In April 2013 Ben had 6 credit cards with various providers totalling $55,000. And although he was working he wasn't managing his repayments and cost of living expenses very well so he signed up with a Budgeting Service so he could "get his credit card debt sorted out'.

The Budgeting Service proceeded to make agreed repayments on his credit cards but more often than not these repayments were not even the minimum amounts required.

In late 2015 Ben was made redundant and received a lump sum payment of $38,000 from his employer. Even though the Budgeting Service had been paying his bills for a number of years it appears that at no stage did the Budgeting Service:

- highlight to Ben that he had a number of income protection and consumer credit insurance policies he had been paying for which he could have claimed against. In fact the Budgeting Service kept paying his income protection policy payments when there was no income to protect;
- review his situation and make arrangements or offers of settlement with his creditors instead they just kept making the previously agreed repayments, holding his money and keeping his interest for themselves, charging him fees and depleting his savings until there was nothing left.

When Ben finally left the Budgeting Service in late 2017 with the help of his social worker he had more debt than when he had started with a Personal Loan and 4 credit cards totalling $60K.

He is now in the hands of a financial counsellor who has helped bring his budget back into balance and negotiated positive outcomes bringing his total credit debt down to $21,000.

C151499

Many people who sign up with money managers are the least who can afford them and the service only exacerbates financial hardship

Many consumers signed up for a money management service when they are already struggling financially and have a clear budget deficit – only to have to pay not insignificant fees.

Debt Agreement Brokers

Debt Agreements are an alternative to bankruptcy for people who are unable to pay their debts as they fall due. Debt Agreement brokers will often offer to provide "free consultations" with over the phone, during which they may discuss “options” and suggest that entering into a debt agreement is the best or only option. This is often not the case. A Debt Agreement is an insolvency option under the Bankruptcy Act and has serious consequences.

The people who engage a debt agreement broker are charged fees that further entrench financial hardship

People are generally charged non-refundable fees for the service regardless of whether the Debt Agreement is successfully negotiated. The fee is sometimes disguised as a “cancellation” fee charged when a customer decides not to engage the company after giving verbal consent over the phone. Debt Agreement brokers rarely advertise their fees and there is a wide range of fees charged in the industry. When people first make contact with a Debt Agreement broker, the broker is likely to structure payments to make it seem like the arrangement is affordable. But in signing up and incurring an ongoing cost, consumers are effectively adding another creditor to their list.

Case study 26 –Nick’s story

In 2011, Nick was struggling with approximately $56,000 in credit card debt, and had recently lost his job. He approached Debt Agreement to obtain a debt consolidation loan, but was instead placed in a debt agreement without any discussion of Paul’s debt management options.

Debt Agreement placed Nick in a terrible debt agreement with payments of $140 per week. The budget prepared by Debt negotiators showed that after these payments and essential living expenses, Nick only had $27 per week. Nick managed to adhere to these payments until 2014 when he again lost his job. He then began to pay whatever he could towards the debt agreement.

The agreement was terminated in August 2017, by which time Nick had paid $32,000 under the debt agreement, and was only $4,000 in arrears. Upon the termination of the debt agreement, Nick’s original debts became payable with interest. While any payments received by his creditors would be set off against his debts the significant percentage of the payments made which went to his Debt Agreement Administrator have been essentially wasted.

C149482

People are placed into unsuitable options leading to prolonged, worsened financial situations

Debt Agreement brokers do not explain that someone may be better off making financial hardship arrangements with their creditors. Many creditors will consider flexible arrangements and in some cases stop interest. In comparison a Debt Agreement includes fees that will often mean that a Debt Agreement is more expensive than making financial hardship arrangements.

Other people who enter into a Debt Agreement find that some years later they are still struggling financially and end up filing for bankruptcy. For some this would have been the better option to begin with, saving both time and money. Because Debt Agreement brokers benefit from the fees generated by a debt agreement their advice may be about what is best for them rather than what is best for the client.

“Brokers” generally suggest that the business will source services from a range of providers and obtain the best deal. This is generally not the case with Debt Agreement brokers who are probably better described as paid referrers, being generally aligned with one administrator and appearing to operate as an intermediary of shield, protecting the licensed administrator from closer scrutiny.

Debt agreement broker tactics can increase stresses

Consumer have reported to Financial Rights feeling bullied, worn down and at times misled into giving their consent and account details.

Debt Negotiation

Debt Negotiation is a negotiation between the debtor and their creditor or creditors to settle a debt on terms which are beneficial to both parties. Debt Negotiators present debt negotiation as something they do as experienced “professionals". But in most cases they are far from it.

Case study 27 –Anand ’s story

Anand is a 66-year old divorcee who immigrated to Australia from India. He operates his own financial planning business. Following a series of difficulties in his personal life, Anand found himself in a large amount of debt. This included a large taxation debt with the ATO of $260,000 and numerous credit card debts totaling approximately $300,000. He was also under mortgage stress.

Anand initially consulted a professional insolvency firm (**PIF**), and was quoted $30,000 to enter into a personal insolvency agreement. The PIF recommended that Anand lodge a hardship application with the ATO and advised him that the ATO should respond within 56 days.

Meanwhile, Anand separately approached his Bank to refinance his home loan to obtain funds to repay his other creditors. As a result of this, he was able to obtain a pool of $140,000 to allocate to other creditors.

Anand’s accountant, Mr. R attended a seminar held by Mr. H, the principal of a Credit Negotiation Service. The accountant suggested Anand contact the Credit Negotiation Service to see if they could help him with his debts.

When Anand first contacted the negotiator, he told them that he wanted to avoid a personal insolvency agreement under Part IX due to the impact on his reputation as a financial planner. Anand stressed that he expected the $140,000 funds (from refinancing of the home loan) would be used to achieve a settlement with both the ATO and the credit card debts.

The Credit Negotiation Service agreed to negotiate with his creditors have his debt reduced in return for a fee based on a percentage of the reduction. Anand that:

(a) was to pay the Negotiator a fee equal to 22% (plus GST) of all funds that they will successfully save via negotiation with creditors (or 11% in the case of the ATO debt). Such fees will be payable on or before settlement of the negotiated creditors but subject to the negotiator providing written evidence of the negotiated figures; and

(b) no "fee" would be payable if no funds are saved via negotiations with creditors. This credit contract will be deemed not applicable if this service will place me/us at further financial disadvantage.

Mr. R (as Anand's tax agent) initially liaised with the ATO in relation to Anand's tax debt. The ATO later waived the general interest charges and late penalties reducing the overall debt from $260,000 to $155,321. There was some question as to whether this reduction was the result of discussions with Mr. R or whether it was a result of any involvement of the negotiator.

The Negotiator proceeded to liaise with Anand's creditors. However, despite the terms of the agreement, they were not forthcoming with details of any conversations that they had with the ATO or the other creditor. Nor did they provide Anand with written evidence of all debt reductions that they had successfully negotiated. Rather, it was not until Mr. P received a invoices for their fees that he learned about any "reduction".

Anand ended up paying a total of $58,000 in fees to Negotiator comprising $7,750 in respect of the tax debt reduction (being 11% x $64,000 + GST). The balance of $50,250 was for 22% of the supposed reduction of the credit card debts.

Whilst it appears the Negotiator did "successfully" negotiate reduction of a number of credit card debts, the ATO debt was not dealt with appropriately because under the tax law, the Commissioner has priority over unsecured creditors. Therefore, they should have addressed this debt before negotiating with the other creditors. Accordingly, an outstanding tax debt of $155,000 remained unpaid. This amount exceeds the additional $140,000 funds from the refinancing of his home loan.

Notwithstanding that there was an issue whether the tax debt reduction was the result of discussions between Mr. R (as tax agent) and the ATO or through the Negotiator's involvement, the Negotiator still charged a fee to Anand for a percentage of the tax debt reduction.

Anand ended up in a Part X personal insolvency agreement which he had wanted to avoid in the first place for which he paid a fee of $45,000 (which was significantly higher than the original $30,000 quoted by the PIF).

C149482

Fess charged exacerbate financial hardship

The high fees can also affect customer's ability to make significant repayments towards there debt.

High risk strategies have serious consequences

Some Debt Negotiators advise clients to stop paying debts to create "leverage" with creditors, but this leads to default listings and legal proceedings being commenced. We have heard of debt negotiators misrepresenting circumstances to creditors by exaggerating health or financial circumstances in order to negotiate with creditors on "compassionate grounds?" This can affect ongoing relationships with creditors, if the negotiation fails or the client later intend to get a loan with them.

The lack of strategic advice provided by debt negotiators can impact upon a client's overall financial position with debt negotiators often undertaking ad hoc negotiations which reduce individual debts and entitle them to claim fees under the contract without any regard whatsoever as to whether there has been a net benefit.

Debt Negotiators also at times ask if the client can obtain a lump sum amount by borrowing from friends, borrowing from a mortgage or accessing your superannuation early and use this amount to offer in negotiations, with significant consequences for personal and financial relationships.

Other debt management services

Financial Rights has seen other examples of debt management services that fail to fall within the strictures of the law.

One is paid bankruptcy services. This is where the service will claim to provide free bankruptcy advice and provide paid assistance for consumers filing for bankruptcy in Australia, including completing statutory documentation and lodging documents with relevant bodies.

Financial Rights has found that these services do not adequately explain the consequences of bankruptcy in relation to its risk and impact. This has exposed clients to significant risks, including losing their home or exposing themselves to investigations by trustees.

We have also found that they fail to perform the services pursuant to their contract, including negotiating and liaising with creditors once a bankruptcy is accepted.

Clients of these services are at a significant disadvantage, as after they file for bankruptcy they lose their right to enforce their contractual rights (including refund of fees paid), by virtue of their bankruptcy.

Case study 28 – Larry and Mary's story

Larry and Mary were struggling financially due to illness, a period of unemployment and ongoing health concerns. Mary had accessed her superannuation, and purchased a caravan where they lived. They worked managing the caravan park. Both held significant personal liabilities. They saw an advertisement for a Paid Bankruptcy Service on Facebook. They recall accurately describing their situation, including the ownership of the caravan. They were advised by the company that they could retain the caravan in bankruptcy, and the materials (including the contract and accompanying brochure) indicated the company would assist in negotiating with the trustee for the retention of the asset or for some alternative proposal.

Larry and Mary filed their respective petitions. AFSA appointed a trustee, who upon learning of the assets of Larry and Mary commenced steps to have the assets realised. The Paid Bankruptcy Service failed to return Larry and Mary's calls. They have been left to deal with the AFSA and subsequent private trustee, without any assistance.

Larry and Mary paid $4,000 for the 'assistance' of the Paid Bankruptcy Service.

The Paid Bankruptcy Service did not perform the contract with care and diligence of a prudent advisor in bankruptcy to outline the real risk to the caravan. Instead, significantly underselling the risk to Larry and Mary's home and livelihood. As bankrupts, John and Susan have limited to no recourse in raising their concerns with the Paid Bankruptcy Service.

C170222

Case study 29 – Mick's story

Mick received advice from a Paid Bankruptcy Service after signing an agreement with them in November 2017. He was advised that while his investment property would vest in the trustee during bankruptcy, once bankrupt he could make an offer to the trustee to buy back the property. At the time this advice was provided Mick had $450,000 in debt owing to various creditors. His only asset was an investment property valued between $310,000 and $320,000. He was clearly insolvent and was only receiving Age Pension payments. Following this advice, he has since discovered that he is not in a position to renegotiate his mortgage with his Bank as a result of his insolvency and bankruptcy, and is unable to make an offer to the trustee to buy back the investment property. We also have concerns in relation to the basis on which Paid Bankruptcy Service is providing this advice. In their Standard Client Agreement they note that this is not legal advice, however, it is unclear what qualifications they have to provide this sort of specific advice.

C175389

Another service Financial Rights sees are "buy more time" from home repossession services. These companies market their services to those who appear on court list subject to repossession proceedings. They offer to "buy more time" to assist the home owners to refinance and have their repossession stopped. What usually happens though is that the home owner is sold either an equity stripping product or high cost fringe loan.

These companies were more common in NSW before the court system intervened and curtailed the information being released on home repossession lists. It does still occur in other jurisdictions.

Current regulation of debt management firms

ASIC has confirmed in its report on debt management firms[44] that they do not currently fall within the meaning of 'financial services' or 'financial products' as defined the *ASIC Act 2001* or the relevant provisions of the *Corporation Act 2001*. This means they cannot be licensed, are not required to be members of EDR schemes, are not required to provide any information on their activities and are not subject to regular audits. The 2017 Ramsay review of the financial system external dispute resolution report also found this to be the case.[45] This does not meet the expectation of the community that engaging with a financial service will be overseen by ASIC and provide them with access to justice when things go wrong.

In addition, even if debt management firms were to be licenced under the current laws, the laws as written do not necessarily address the business models that these firms engage in.

Debt management firms do fall within the consumer protection provisions of the *Australian Consumer Law* (**ACL**) but the ACL protections have so far proven to be inadequate to protect vulnerable consumers. There are also significant difficulties in applying the consumer guarantees to new and emerging services such as those provided by debt management firms. For example, how does a consumer or regulator know whether a new and emerging service is "fit for any specified purpose" when there is nothing to compare that new service to and there are no standards set for what is essentially a useless service.

There are also significant complexities and difficulties for consumers (be it individually or collectively) to pursue any action against any debt management firms or any other new and emerging financial businesses. Firstly it is difficult to work out whether a new business model needs to be licenced as an Australian Financial Service licence, secondly actually pursuing this requires Supreme Court action which is costly and complex and thirdly the rescission

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[44] *Paying to get out of debt or clear your record: The promise of debt management firms* (Report 465)

[45] p.198, Review of the financial system external dispute resolution and complaints framework, April 2017 http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Reviews%20and%20Inquiries/2016/Review%20into%20EDR/Key%20Documents/PDF/EDR%20Review%20Final%20report.ashx

provisions under s. 925A of the *Corporations Act 2001* and the interpretation they have been given by the courts have proven difficult for consumers to get their fees returned or receive declaratory relief.

Reforms to address the harms caused by debt management firms

If debt management firms and other new and emerging financial businesses were required to be licensed there would be greater scope for ASIC to gather information, conduct regular risk-based audits for compliance and ensure that these unfair businesses are subject to an external dispute resolution scheme.

The Ramsay Review recommended that debt management firms should be required to be members of an external dispute resolution body and that further work should be undertaken to determine the most appropriate mechanism by which to impose this requirement, for instance, licensing.

Improving the capacity of the financial counselling sector, discussed in the next section below, is also crucial to combat the harm arising from debt management firms. As are community legal centres. In many cases there are free options available to debtors that would achieve the same result or significantly better, but the services that would assist people to access those options are under-resourced and cannot possibly compete with the capacity and advertising clout of the for profit sector.

Debt Repayment Service – a joint industry/community initiative.

After years of discussion and preparatory work, “Wayforward Debt Solutions” was incorporated in late 2018, an independent, not-for-profit service governed by a Board of industry and consumer representatives. Wayforward will offer an alternative debt repayment service for people with multiple creditors who can pay some, but not all, of their debts. Initially the four major banks only are involved and referring their customers to a pilot program. The intention is to broaden this to include other credit providers as soon as possible, provided the pilot is successful.

The service will be free to consumers and will operate on a clients’ best interests basis to ensure that clients are only put in sustainable and appropriate solutions. There are potential benefits to both debtors and credit providers from model, as the high fees currently extracted by for-profit debt management firms are currently absorbing a significant percentage of the amounts debtors have available for repayment.

The partnership approach to this enterprise is intended to make sure clients interests are kept in the forefront and to ensure its independence from industry and specific creditors. Clients who may have a defence to their debts, or for whom other more suitable options may be available, will be referred back to the financial counselling and community legal sector and other suitable community support services.

Wayforward is a member of AFCA.

This is a very exciting initiative that will give consumers another more attractive option to the services operated by for profit debt management firms. It is unlikely, however, that for profit services will cease to operate, or that consumers won't continue to be attracted by their extremely effective advertising. Regulation is essential to address continuing harm in this space.

Recommendations

9. **The Government should adopt of a "hybrid model" (a rule-based regime combined with a licensing system) for the regulation of all Debt Management Firm. This would include:**
10. **Mandatory licensing and reporting (by expanding the definition of 'credit assistance' 'advice', under the *National Consumer Credit Protection Act 2009* and 'financial services' and 'financial products' under the *ASIC Act 2001* and the *Corporations Act 2001*;**
11. **A 'best interests' duty modelled on Future of Financial Advice Reforms;**
12. **Mandatory internal dispute resolution and membership of AFCA.**
13. **Conduct obligations including**
    a) **prohibition of upfront fees;**
    b) **disclosure obligations regarding fee structures, and advising consumers of free alternatives that can assist, such as hardship programs, external dispute resolution and free and independent financial counselling services such as the National Debt Helpline;**
    c) **a ban on unsolicited sales, mandatory cooling-off periods or in the alternative, a deferred opt-in period.**
14. **Client money obligations modelled on the Financial Conduct Authority** (FCA) **UK's Handbook rules[46] including:**
    a) **mandatory trust accounting such as making adequate arrangements to safeguard the client's rights and prevent the use of client money from its own account when holding client money;**
    b) **introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client money, or of rights in connection with client money, as a result of misuse of client money, fraud, poor administration, inadequate record-keeping or negligence;**
    c) **ensuring client monies are directly deposited into a client bank account at an approved bank with continued obligations to assess the appropriateness of a bank at least once each financial year;**

[46] The FCA UK is empowered under. Section 138G of the *Financial Services and Markets Act 2000 (UK)* to make rules. The FCA publishes a Handbook under this provision which provides a number of rules creating binding obligations on financial services including debt management firms. The Handbook contains a 'Debt management client money chapter' (**CASS 11**) within the Client Assets Sourcebook, which applies to 'CASS debt management firms'.

d) a prohibition on retention of interest earned from client accounts;

e) obligations to ensure that client monies are paid to creditors as soon as reasonably practicable,[47]

f) keep such records and accounts as are necessary to enable it, at any time and without delay, to distinguish client money held for one client from client money held for any other client, and from its own money

g) on receipt of a written request to withdraw from a debt management plan, promptly return to the client money held by it for the client

h) maintain up-to-date records that detail all payments to, from, or made on behalf of, clients and written and oral contact with clients and their creditors

i) undertake periodic checks of internal records and reconcile differences and discrepancies

15. Robust entry standards including:

    a) a fit and proper person test,

    b) educational qualifications and

    c) sufficient processes to adequately monitor compliance with obligations.

16. Require that arrangements are 'suitable' for clients

17. Apply Design and Distribution Obligations and Product Intervention Powers and give ASIC the power to ban particular products or practices

18. Implement a co-regulated Code of Practice to address practical issues in a similar fashion to the banking and insurance sectors, as recommended in the ASIC Enforcement Review

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[47] In the UK there are also rules for when a firm does not propose to make a client's payments to creditors within a specific amount of time, which require either communication with the client's creditors or the client depending on the applicable circumstances. Where a firm receives client money from a client in relation to a debt management plan or for the purpose of distribution to the client's creditors, and it fails to pay that money to creditors as soon as reasonably practicable following its receipt, must put the client into the financial position he would have been in had the delay not occurred

Capacity and capability of the financial counselling sector

We refer to and draw on the recent Joint Submission to the Royal Commission from the National Association of Community Legal Centres & Financial Counselling Australia.[48]

In summary, there is currently substantial demand for financial counselling amongst Australian consumers. Community based financial counsellors assist approximately 120,000 clients a year, and the National Debt Helpline (**NDH**) receives 170,000 calls a year. At current resourcing levels the NDH struggles to keep pace with this demand. Waiting times for financial counselling are between two and four weeks, and many services have full waiting lists.

The behavior of the predatory organisations discussed in this submission further strains on the workload for financial counsellors and community legal centres.

Demand for existing financial counselling services has been increasing each year, and there are strong indications that demand will continue to increase.

Credit card debt may have reduced since 201 but it remains extremely high at $31.7 billion. Further ASIC recently identified that as at June 2017 there were over 1.9 million people who were either making repeated low payments towards their debts, had persistent debt on at least one card or were in serious or severe delinquency on at least one card account. The 2015 report by Digital Finance Analytics indicated that growing numbers of Australian households were experiencing financial hardship, with approximately 21% of households in financial distress. Since that time the ratio of household debt to income in Australia has continued to climb and at 190% is high by historical and international standards and the household savings to income ratio has dramatically reduced.

There are also a number of population groups who currently face particular barriers to accessing financial counselling and legal advice in relation to debt and financial services problems including victims of domestic violence, small business people, farmers and people who have been given poor financial advice.

The current service provision to people who are facing problems arising from debt problems and hardship arising from credit and financial services targeted at Australians at risk is scattered and patchy. It consists of face-to-face financial counseling services, the National Debt Helpline, which is the phone financial counseling service, and generalist community legal centres and five specialist centres: Financial Rights, Consumer Action Law Centre, Consumer Credit Law Centre South Australia, Consumer Credit Legal Service (WA) and Consumer Law Centre (ACT).

[48] Submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry: A proposal for the industry levy to fund community financial counselling and consumer legal services Joint Submission from the National Association of Community Legal Centres & Financial Counselling Australia 26 October 2018 http://www.naclc.org.au/resources/20181026%20NACLC%20and%20FCA%20Banking%20RC%20Submission.pdf

In the 2017-18 year, across all generalist and specialist CLCs, approximately 20,000 discrete legal services were provided (i.e. legal advices or related tasks) in relation to credit and debt matters, and an additional 2,500 legal representation services provided, that is, lawyers acting for a client, e.g. in a dispute with a bank, with the number of unique people assisted (excluding those provided with basic information) being approximately 15,000 people a year. About a third of these services were provided by the five specialist consumer legal centres (including Financial Rights), with the rest spread out across around 120 legal centres.

At Financial Rights Legal Centre we received 31,550 calls to the National Debt Helpline from NSW residents alone. Of these we were able to answer about 21,000, leaving a significant deficit of unmet demand. The vast majority of these people received advice to self advocate and/or were referred to face-to-face financial counselling services. While we work hard to ensure that our advice is practical and useful and assists people to obtain the maximum benefit possible from industry hardship and internal dispute resolution processes, and the ombudsman schemes[49] we are only resourced to provide ongoing casework assistance (whether legal representation or financial counselling) to a very small proportion of callers – about 1-2%.

Funding of an integrated FC/CLC model

We fully support the call for an integrated network of financial counsellors and community lawyers to ensure that people contacting free and independent financial advice can be assisted on the phone or effectively triaged to legal services or to financial counsellors in the network.

In the 17/18 financial year over 1,100 people who called the National Debt Helpline at Financial Rights were facing legal enforcement processes ranging from a statement of claim to a creditor's petition, (the final stage in the process of making a person bankrupt). As a result over 2,500 people received legal advice, either in addition to, or instead of, financial counselling. Over 100 people received legal representation services, many also receiving in-house financial counselling services to ensure the results achieved by the solicitors were embedded in sustainable financial arrangements going forward. Immediate access to legal advice and assistance is a key advantage of a multi-disciplinary service. A well integrated community legal centre and financial counselling sector can ensure people get the right help when they need it.

A model should be drawn from the principles for a service delivery model developed in the 'Consumer Credit Legal Services in Australia' unpublished ASIC report. In essence: to build on the strengths and address the weaknesses of current service delivery arrangements, target vulnerable and disadvantaged consumers, and maximise coordination between service delivery agencies.

Funding could potentially be provided via an ASIC fee (extending the ASIC industry cost recovery model to include funding for financial counselling and consumer finance legal

[49] From 1 November 2018 this will be the Australian Financial Complaints Authority only. Previously there were two external dispute resolution schemes.

services); or the Major Bank Tax currently levied on banks with liabilities of more than $100 billion (the tax would be increased to cover the proposed funding).

Recommendations

19. **A network of integrated financial counselling and legal services needs to be established and funded through an industry levy or industry tax.**

Other matters

Pawnbrokers

Pawnbrokers give loans while holding goods as security. They must give at least three months to repay the loan in order for goods to be returned, starting from the date the goods were loaned. To fully repay, most pawnbrokers require the initial loan amount, plus interest and often extra fees.

Pawnbroking is often seen as an option of last resort for consumers unable to access mainstream credit, borrow from friends or family or obtain food or electricity vouchers. It is therefore primarily the most vulnerable and disadvantaged members of the community that access loans from pawnbrokers.

Consumers facing underemployment and unemployment are vulnerable to exploitation by pawnbrokers. Financial Rights receives calls from consumers unable to pay immediate living expenses such as food and utility bills and are turning to pawnbrokers for short-term loans. We regularly receive complaints from consumers who have pawned goods to pay for basic necessities or to fund drug or gambling addictions. The Australian Bureau of Statistics uses the incidence of pawnbroking or sale of possessions as one of its nine indicators of financial stress.[50]

Pawnbrokers charge very high interest rates and fees

Pawnbroking often involves extremely high interest rates, fees and other set-up charges. In our experience, pawnbroking contracts often charge interest rates exceeding 20% per month, with some exceeding 80% per month. A study from Victoria found nominal interest rates ranging between 10% and 60% per month, with the majority ranging from 10% to 30%. Given that pawnbroking contracts are typically 3 months or more, this equates to a typical rate of 30% to 90% every three months, or an annualized very high cost of credit.

There is a significant power imbalance inherent to pawnbroking

As pawnbrokers take possession of the pledged item before handing over any money, the position of bargaining power "will always rest behind the counter".[51] There is no protection for essential household goods: a vulnerable person may be backed into a corner where they pawn a car that is necessary to get their children to school. This can leave consumers extremely vulnerable and desperate.

The power of pawnbrokers is protected by their ability to sell the goods once the redemption period expires if the client doesn't repay everything that the pawnbroker

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[50] *Household Expenditure Survey and Survey of Income and Housing*, ABS 6503.0, 2009-2010 http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/1D03ACBBD40275ADCA257A3900173E85/$File/65030_1.pdf

[51] Pawnbrokers thriving as poorest hurt in slowdown, Bloomberg, Business Day July 1, 2013 Read more: http://www.smh.com.au/business/pawnbrokers-thriving-as-poorest-hurt-in-slowdown-20130701-2p5uh.html#ixzz2eS6zUdcm

demands. The amount loaned is usually far less than the value of the goods pawned. Pawnbrokers are in the position of power in negotiating in relation to how much to offer a consumer for an item, and how much to charge in fees and interest.

Pawnbrokers have no obligation to assess customers' capacity to pay

Many consumers engage pawnbrokers as an option of last resort when they cannot access mainstream credit. In Financial Rights' experience, pawnbrokers commonly do not make any enquiries as to customers' ability to repay loans they provide.

Pawnbrokers have no incentive to check if consumers are able to repay a debt, as the loans they provide are secured by goods. Pawnbrokers often only lend up to a quarter of the amount of the resale value of the secured goods. This means that in cases where the customer is unable to repay the loan, the pawnbroker can sell the goods to recover money and costs, as well as gaining any interest payments already made by the customer prior to the sale of the goods. Some consumers struggle for years against mounting interest and charges with each renewed pledge, before their goods are eventually sold anyway. Others do manage to repay their debt, only after having paid extremely high rates of interest and charges.

Pawnbroking is low-risk for brokers

There are risks inherent in lenders lending to low income and disadvantaged groups, but the fact that pawnbroking is a form of secured credit puts pawnbrokers in a more favourable position than that of payday lenders. Payday lenders have similar customer bases but are subject to the requirements of the *National Consumer Credit Protection Act 2009*, while Pawnbrokers are exempt.

Pawnbroking is one of the most under-regulated forms of credit, and there is a risk of downward drift of predatory operators away from other types of credit into pawnbroking.

Case study 30 – Claire's story

Claire is an Aboriginal single mother who lives on Abstudy and Family Tax Benefit payments. She and her daughter are domestic abuse survivors, in relation to which Claire's ex-partner is now serving a lengthy jail term.

In December 2016, Claire attended a Pawn Shop, wanting to pawn her car (purchased for $4,500 six months prior) to borrow $400 for that week's rent, but was told the minimum she could borrow was $700 with monthly interest payments. Claire said that she could not afford that but was told it was her only option.

In March 2017 the car was about to be sold as Claire had been unable to pay back the loan within the 3-month pawn period. At this stage Claire was homeless, on the waiting list for emergency accommodation, and surviving on the charity of a local church organisation. She offered to pay the pawnbroker $50 per fortnight, but this was refused.

Financial Rights wrote to the pawnbroker raising a dispute on the basis that the pawn contract was unjust as the pawnbroker could have ascertained by reasonable inquiry that

Claire could not afford the pawn without substantial hardship.

The pawnbroker offered to settle on the basis that Claire paid the $700 principal within one month – waiving the $880 in interest plus the storage fees claims – at which stage they would return her car.

Claire did not have $700 or capacity to raise the money within a month, however Claire's financial counsellor persuaded the local church support group to fundraise; within a day they had raised the sum and went with Claire to pay it and collect her car.

Source: C141684

A number of payday lenders have shopfronts that offer both pawnbroking and payday lending services that clearly target disadvantaged Australians. We have heard cases of consumers being provided with a payday loan to repay a pawnbroking loan at another counter within the same store. The same obligations and protections should apply for these services.

Current regulation of pawnbrokers

Despite there being an inextricable link between payday lending and pawnbroking, pawnbrokers are expressly excluded from the operation of most of the national credit laws under the *National Consumer Credit Protection Act 2009*.[52]

Instead, pawnbrokers are regulated by state and territory legislation. As a result, pawnbrokers are not subject to the requirements around responsible lending, limits on fees and charges of small loans, and the requirement on providers to be members of external dispute resolution scheme.

In NSW pawnbrokers must hold a pawnbrokers licence issued by NSW Fair Trading as per the *Pawnbrokers and Second-Hand Dealers Act 1996*. By law all licensed pawnbrokers must display certain signs in their premises which are visible to customer, provide a copy of a pawn ticket and notices including certain information regarding fees etc.

Pawnbroking is subject to the unjust transaction provisions of the National Credit Code. However, this protection is largely illusory for the vulnerable consumers targeted by these businesses because there is no accessible forum where a consumer can make a complaint. Pawnbrokers are not required to be members of an external dispute resolution scheme.

Reforms to address the harms caused by pawnbrokers

We note that in the UK, their Consumer Credit Act applies to all forms of consumer credit, including licensed pawnbroking. Consumers there have access to the UK Financial Ombudsman Service and small claims courts for disputes

[52] Insert ref

Recommendations

20. Pawnbroking laws should be nationalised with a uniform Code and be subject to the same consumer protections regulations provided by the National Consumer Credit Protection Act 2009 including:

    a) Mandatory access to internal dispute resolution procedure;

    b) compulsory membership of pawnbrokers in the external dispute resolution scheme AFCA;

    c) maximum interest rate caps

    d) maximum cap on fees;

    e) strengthened disclosure requirements including:

    f) spelling out the total amount of interest payable the total loan amount and any fees, in monetary terms (not just in percentage terms).

    g) an obligation to advise the consumer of other options for short-term financial assistance and to advise the consumer where he or she can go for assistance in case of financial hardship

    h) a 30-day Warning of Sale notice

    i) consumers are advised of any surplus.

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 Financial Rights on (02) 9212 4216.

Kind Regards,

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